IN THE

Supreme Court of the United States

OCTOBER TERM 1975

No. 75-1753

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC. and KIRBY LUMBER CORPORATION,

Petitioners,

against

S. WILLIAM GREEN, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

WILLIAM R. GLENDON
Attorney for Petitioners
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

Of Counsel

ROGERS & WELLS
Guy C. Quinlan
Gene M. Bauer
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

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Petitioners respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this action on February 18, 1976, as to which rehearing was denied on March 10, 1976. That judgment reversed in part a judgment of the United States District Court for the Southern District of New York, which dismissed respondents' complaint against petitioners under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and state law, for failure to state a claim and for lack of subject matter jurisdiction.

In denying rehearing in this and another case involving Rule 10b-5, the Court of Appeals noted:

> "This Court has denied en banc, not because we believe these cases are insignificant, but because they are

of such extraordinary importance that we are confident the Supreme Court will accept these matters under its certiorari jurisdiction, as we correctly anticipated in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1020 (2d Cir. 1973), *vacated,* 417 U.S. 156 (1974).

* * *

"Accordingly, we speed these cases on their way to the Supreme Court as an exercise of sound, prudent, and resourceful judicial administration." (87a-88a)*

Citations to Opinions Below

The opinion of the United States District Court for the Southern District of New York, reported at 391 F.Supp. 849, is printed as Appendix B. The opinion of the United States Court of Appeals for the Second Circuit (not yet officially reported) reversing in part the judgment of the District Court, is printed as Appendix C. The memorandum of the Court of Appeals denying rehearing *en banc* is printed as Appendix D.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on February 18, 1976. Petitioners' timely petition for rehearing was denied on March 10, 1976.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

1. May an action be maintained under Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, on the basis of an allegation that the stock of minority stockholders of a company involved in a short form merger was undervalued, where there is no allegation of any misrepresentation or nondisclosure, and where it is conceded that the material facts were fully disclosed to the minority stockholders?

2. Do Section 10(b) and Rule 10b-5 authorize a federal court, in the absence of any allegation of misrepresentation or nondisclosure, to condemn, as a breach of corporate "fiduciary duty", conduct which is expressly sanctioned by the state which created the corporation, and to impose requirements of "corporate purpose" and advance notice on the use of a state short form merger statute, when it is conceded that the law of the state imposes no such requirements?

* Citations to "   a" are to the Appendix to this Petition.

Statutes and Rules Involved

Involved herein are the Tenth Amendment to the Constitution of the United States, Section 10(b) of the Securities Exchange Act of 1934, 15 USC § 78j(b), Securities and Exchange Commission Rule 10b-5, 17 CFR 240.10b-5 and Sections 253 and 262 of the Delaware Corporation Law, the texts of which are printed in Appendix A hereto.

Statement of the Case

The facts relevant to the issues presented by this Petition are not in dispute. Since 1936, a controlling interest in Kirby Lumber Corporation ("Kirby"), a company organized under the laws of Delaware, was owned by Santa Fe Natural Resources, Inc. or a predecessor ("Resources") which in turn is wholly-owned by Santa Fe Industries, Inc. ("Santa Fe"), the parent company of the Santa Fe Railway. For several years, Resources had owned approximately 95 percent of the stock of Kirby. Plaintiffs were among the minority stockholders who owned the remaining 5 percent.

Delaware, like 37 other states (63a), has enacted what is commonly referred to as a "short form merger statute", which permits a parent corporation owning a substantial percentage of the stock of a subsidiary (90 percent in the case of Delaware) to merge with that subsidiary, and to pay for the minority shares in cash. As the Court below recognized (41a), the Delaware statute does not require any showing of a corporate purpose for the merger, nor does it require advance notice thereof. Notice of the merger must, however, be given within ten days after its effective date, and any stockholder who is dissatisfied with the amount of cash offered is entitled to demand an appraisal in the Delaware Court of Chancery. DCL §§ 253 (d), 262.*

Resources determined to invoke the provisions of Section 253. It obtained written appraisals of the physical assets of Kirby, which were furnished to Morgan Stanley & Co. in connection with its valuation of the stock (Appendix 27A-28A).** Morgan Stanley submitted a report valuing the stock at $125 per share. Resources thereafter decided to offer the minority stockholders $150 a share.

To implement the merger, Resources caused to be organized another Delaware corporation, Forest Products, Inc. ("FPI"), and transferred to it the funds necessary to purchase the minority shares (Appendix 18A). The merger was completed and, within the time specified by Delaware law, notice thereof was sent to the minority stockholders.

Accompanying the notice was an information statement (Appendix 12A-71A) which included, in addition to the

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* The Delaware statute was amended on April 24, 1976. The amendments, which provide further procedural rights to stockholders seeking appraisal, do not affect the issues in this action. The text of the amendments is reprinted in Appendix A.

** Citations to "Appendix A" are to the Appendix on Appeal in the Second Circuit.

Morgan Stanley valuation and extensive financial data on Kirby, the appraisals of the physical assets. Respondents did not dispute herein that all of the material facts relating to the transaction were made available to the minority stockholders. As Judge Moore noted in the dissenting opinion (67a);

> "At this point it is essential to underscore what was *not* involved in the merger. [Emphasis in original.] There was no failure to comply with state law. There was no failure to disclose by the defendants. On the contrary, all of plaintiffs' assertions of stock value derived from the report circulated by the defendants to the minority shareholders. Similarly, there was no misrepresentation of fact or law made to the minority."

On August 21, 1974, the plaintiffs invoked their right of appraisal under Delaware law. On September 9, 1974, however, respondents purported to withdraw their demand for appraisal,* and filed the present action on the following day.

It is upon these facts that the majority of the Court below held that the complaint stated a claim under Rule 10b-5, "without any charge of misrepresentation or lack of disclosure" (36a), by alleging the absence of advance notice of the merger and the lack of a "corporate purpose" therefor, even though the law of Delaware concededly required neither, and even though there was no charge of misrepresentation or nondisclosure in connection therewith (36a).

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* However, a number of other stockholders pressed their requests for appraisal, and discovery proceedings are now in progress in the Delaware Court of Chancery. *Bell, et al.* v. *Kirby Lumber Corporation*, C.A. No. 4076.

Thus, the majority of the Court below has made a radical transformation of Rule 10b-5 by holding, as the dissenting opinion noted (68a) "that failure to disclose is no longer a prerequisite for liability under Rule 10b-5—that, in fact, liability under the anti-fraud provisions of 10b-5 will attach in the *complete absence* of any deception or misrepresentation, in short, in the complete absence of fraud altogether." [Emphasis in original.] In holding that a scrupulous observance of the Delaware short form merger statute constituted, in itself, a device or artifice to defraud, the Court below has also taken a sweeping step toward the re-creation of a federal common law of corporations. The Court of Appeals has also opened the way for a drastic increase in the volume of litigation under Rule 10b-5, by imposing upon the federal courts the burden of determining valuation and appraisal cases, which would otherwise be heard in the state courts where they belong.

REASONS FOR GRANTING THE WRIT

The Decision of the Court Below Presents Important Federal Questions for Decision by This Court.

A. The Elimination by the Court Below of Misrepresentation and Nondisclosure, as Necessary Elements of a Claim Under Section 10(b) and Rule 10b-5, Should Be Reviewed by This Court.

The novel holding of the Court below extends the scope of Rule 10b-5 far beyond any previous authority, and raises a substantial and serious federal question. Indeed, the Court of Appeals has in effect revised the statute from a disclosure provision to a charter for the substantive regulation of state corporation law. In so doing, the Second Circuit impliedly overruled a long line of its own decisions, including *Popkin* v. *Bishop*, 464 F.2d 714 (1972).

In *Popkin,* the Court of Appeals noted, after reviewing a number of recent 10b-5 decisions (pages 719-720):

> "Thus, it seems clear that our emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases. Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited."

Nothing in the prior decisions of this Court furnishes any basis for the radical break, by the Court below, with the *Popkin* line of authority. Indeed, it was less than a year before the decision below that this Court had reaffirmed the historical relationship of Rule 10b-5 to the "tort of misrepresentation and deceit". *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 744 (1975). Nor is any basis for the decision below furnished by this Court's prior holding that the "fundamental purpose" of the 1934 Act is "to substitute a policy of full disclosure for the philosophy of *caveat emptor* . . ." *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 151, citing *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 186.

The Court below nevertheless held that a claim had been stated under Rule 10b-5, although respondents had conceded the absence of any deceit (Principal Brief, p. 33), and had admitted that "the gravamen of [their] complaint" was merely the alleged undervaluation of their stock. Such a radical departure from prior existing law fully justified the Court of Appeals, in its *en banc* decision, in describing this case as of "such extraordinary importance" (87a) that it was deserving of early review by this Court.

The holding of the majority below is not only novel and serious in its potential consequences: it also is in apparent conflict with general principles most recently stated by this

Court in *Ernst & Ernst* v. *Hochfelder,* —— U.S. ——, 44 U.S. Law Week, 4451, 4455 (March 30, 1976). Indeed, the holding below appears to conflict with the language of the statute itself.

As the Court noted in *Hochfelder,* any construction of Rule 10b-5 must "turn first to the language of § 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself' ". 44 U.S. Law Week, page 4455, quoting *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756. That statute, as the Court further noted in *Hochfelder,* makes unlawful the use of "any *manipulative or deceptive* device or contrivance" [emphasis added] in contravention of rules established by the Commission. But no allegation of manipulation, as the term is used in the statute, is here involved.* The issue, therefore, is whether the statute which prohibits "deceptive" devices can be stretched to cover cases where there is a conceded absence of any deception whatsoever.

The Court of Appeals sought to fill this gap by finding and substituting a breach of fiduciary duty in place of the requisite deceit. Thus, it imported into the statute a requirement that a short form merger must be accompanied by an express corporate purpose and that notice of such a merger be given in advance, although neither of these requirements is in the statute. The fiduciary breach then was found in the absence of compliance with these judicially created requirements. In so doing the majority, as Judge Moore stated (80a), "has not provided a remedy to correct a fraud; rather it has extended to these plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws."

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* As this Court noted in the *Hochfelder* case, 44 U.S. Law Week, page 4456, the term "manipulative" was "virtually a term of art . . . [relating to] conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities".

Petitioners submit further that the grave questions raised by the decision below are not answered by asserting that Rule 10b-5 "must be read flexibly, not technically and restrictively" (42a-43a). Undoubtedly, the statute can be read "flexibly" to reach new and ingenious forms of fraud and deceit. Flexible interpretation, however, cannot validly be stretched to "add a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Hochfelder, supra,* at page 4455. As the Court further held in *Hochfelder,* page 4460:

> "More importantly, Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute,' *Dixon* v. *United States,* 381 U.S. 68, 74 (1965), quoting *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134 (1936). Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)."

So here, the Court below, in eliminating deception as a requirement under the Rule, has exceeded the authority granted by Congress in Section 10(b). Petitioners submit that the principle stated in *Hochfelder* is controlling here, and that the Court of Appeals, like the Commission, is without authority to rewrite the statute. Petitioners respectfully urge that this Court should resolve the question of whether a statute which "speaks so specifically in terms of manipulation and deception" (*Hochfelder, supra,* page 4460) can be construed to apply to situations where manipulation and deception are concededly absent.

The decision of the Court below is also in direct conflict with the holdings of the Fifth and Seventh Circuits that

"the gravamen of a 10b-5 cause of action is deception", and that no action under the Rule may be maintained in the absence thereof. *Bailes* v. *Colonial Press, Inc.*, 444 F.2d 1241, 1246 (5th Cir. 1971). *Accord, Rosin* v. *New York Stock Exchange, Inc.*, 484 F.2d 179, 183 (7th Cir. 1973), *cert denied*, 415 U.S. 977. *See, also, Aboussie* v. *Aboussie*, 441 F.2d 150 (5th Cir. 1971); *Azalea Meats, Inc.* v. *Muscat*, 386 F.2d 5, 8 (5th Cir. 1967).* Petitioners submit that this is a further indication of the substantial and serious nature of the issue presented, and of the need for a resolution by this Court.

And finally, the decision below would vastly increase the volume of federal litigation under the securities laws. The holding of the majority (36a), that an action may be brought under Rule 10b-5 for "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure" would mean that the District Court will henceforth be obliged to hear, as purported claims under the securities laws, a wide variety of claims which previously have been matters for state law exclusively. In reaching this result, the majority of the Court below has disregarded "the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5" (See *Blue Chip Stamps* v. *Manor Drug Stores, supra,* at 421 U.S. 740). Petitioners submit that the radical expansion of the Rule by the decision below calls for the exercise of this Court's supervisory powers.

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* The concurring opinion in the Court below cited *Rekant* v. *Desser*, 425 F.2d 872 (5th Cir. 1970), for the proposition that the Fifth Circuit has ruled 10b-5 applicable to "corporate insiders" even in the absence of misrepresentation or nondisclosure (61a). In *Rekant*, however, the Fifth Circuit expressly based its holding on findings that the defendants had made "affirmative misrepresentations" in reports to shareholders, and had "violated the directors' duty to disclose fully the material facts . . ." (425 F.2d at page 882).

B. The Decision of the Court Below Would Create a Federal Common Law of Corporations Contrary to Valid State Statutes.

The majority of the Court below held that the complaint sufficiently pleaded a breach of corporate "fiduciary duty", in alleging that the short form merger was implemented without advance notice to minority shareholders, and without a valid corporate purpose (45a, 47a-48a). The Court below specifically recognized that the applicable Delaware statute provides for elimination of minority interests under 10 percent "without prior notice to the minority shareholders" and "without any statement of corporate purpose" (40a). The majority nevertheless proceeded to hold that following the short form merger procedure, expressly sanctioned by the legislature and Courts of Delaware, constituted in itself a "fraud" and breach of "fiduciary duty" as a matter of federal law. It did so in a situation where the Supreme Court of Delaware has clearly held that no such fiduciary duty exists, and that the holders of a less than 10 percent minority interest have no vested right to remain stockholders. *See, e.g., Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78, 80 (Del. Sup. Ct. 1962). ("This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of breach of trust. . . .")

Petitioners submit that the holding below is in direct conflict with the spirit of applicable decisions of this Court, from *Erie R. Co.* v. *Tompkins*, 304 U.S. 64, to *Cort* v. *Ash*, 422 U.S. 66. In seeking to transform Section 10(b) and Rule 10b-5 from disclosure provisions to charters for the substantive revision of state corporate law, the majority was clearly moved by its disapproval of the policy underlying Delaware statutes "thought to be favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the mem-

bers of the legal profession located in Delaware" (40a).* The issue thus is squarely presented as to whether Section 10(b) authorizes, in the words of the dissenting opinion below (63a), "the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven States". Petitioners submit that it does not, and that the attempted re-creation of a federal common law of corporations clearly calls for review by this Court. As this Court held in *Cort* v. *Ash, supra,* in disallowing a federal civil damage remedy for illegal corporate political contributions (pp. 84-5):

> "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.
>
> * * *
>
> "We are necessarily reluctant to imply a federal right to recover funds used in violation of a federal statute where the laws governing the corporation may put a shareholder on notice that there may be no such recovery."

See, also, Cohen v. *Beneficial Loan Corp.,* 337 U.S. 541, 550-1.

In the absence of any showing of congressional intent to preempt this area—and no such showing, as indicated above, can be derived from the language of the statute—it is irrelevant whether the Court below was right or wrong in its disapproval of the policy judgments embodied in the

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* In fact, as noted in Judge Moore's dissent (63a), at least 38 of the 50 states have similar statutes.

Delaware statute. As this Court recently held, in disapproving another excursion by the Second Circuit into the fashioning of state corporation law (*Lehman Bros.* v. *Schein,* 416 U.S. 386, 389):

> "Such a construction of *Diamond,* the Court of Appeals said, would have 'the prophylactic effect of providing a disincentive to insider trading.' Id., at 823. And so it would. Yet under the regime of *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), a State can make just the opposite her law, providing there is no overriding federal rule which preempts state law by reason of federal curbs on trading in the stream of commerce."

The dangers of creating federal common law in this area were forcefully stated in a recent commentary, cited, curiously enough, by the majority of the Court below. Borden, *Going Private—Old Tort, New Tort or No Tort?* 49 N.Y.U. L.Rev. 987 (1975). After recalling the unfortunate developments under the doctrine of *Swift* v. *Tyson,* Professor Borden noted (p. 1039):

> "If the federal securities laws are to be pushed so far beyond their original purpose as not only to enforce recognized standards of fiduciary obligations but to create new ones in a hotly debated area without deference to state law or empirical study of any balancing of the numerous competing social interests involved, one may suppose that one day there will again be a recognition of the 'mischievous result' of judicial law-making based upon an alleged 'transcendental body of law outside of any particular State' which federal courts in their good judgment may discern and apply. We will then have in the securities field our own *Erie* v. *Tompkins.*" [Footnotes omitted.]

We submit that this outcome should not wait for a demonstration of the "mischievous results" which would

follow from a revival of *Swift* v. *Tyson* in this area. Petitioners respectfully urge this Court to halt such a development in its incipiency, by reviewing and then reversing the decision below.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

William R. Glendon
Attorney for Petitioners
200 Park Avenue
New York, New York 10017

Tel. No. (212) 972-7000

Of Counsel

Rogers & Wells
Guy C. Quinlan
Gene M. Bauer
200 Park Avenue
New York, New York 10017

Tel. No. (212) 972-7000

Appendix A—Statutes and Rules Involved.

UNITED STATES CONSTITUTION AMENDMENT X

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULE 10b-5

§ 240.10b—5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. (Sec. 10; 48 Stat. 891; 15 U.S.C. 78j) [13 F.R. 8183, Dec. 22, 1948, as amended at 16 F.R. 7928, Aug. 11, 1961]

DELAWARE CORPORATION LAW

§ 253. Merger of parent corporation and subsidiary or subsidiaries

(a) In any case in which at least 90 percent of the outstanding shares of each class of the stock of a corporation or corporations is owned by another corporation and one of such corporations is a corporation of this State and the other or others are corporations of this State or of any other state or states or of the District of Columbia and the laws of such other state or states or of the District permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction, the corporation having such stock ownership may either merge such other corporation or corporations into itself and assume all of its or their obligations, or merge itself, or itself and one or more of such other corporations, into one of such other corporations by executing, acknowledging and filing, in accordance with section 103 of this title, a certificate of such ownership and merger setting forth a copy of the resolution of its board of directors to so merge and the date of the adoption thereof; provided, however, that in case the parent corporation shall not own all the outstanding stock of all the subsidiary corporations, parties to a merger as aforesaid,

the resolution of the board of directors of the parent corporation shall state the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation. If the parent corporation be not the surviving corporation, the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor, and the certificate of ownership and merger shall state that the proposed merger has been approved by a majority of the outstanding stock of the parent corporation entitled to vote thereon at a meeting thereof duly called and held after 20 days' notice of the purpose of the meeting mailed to each such stockholder at his address as it appears on the records of the corporation. A certified copy of the certificate shall be recorded in the office of the Recorder of the County in this State in which the registered office of each constituent corporation which is a corporation of this State is located. If the surviving corporation exists under the laws of the District of Columbia or any state other than this State, the provisions of section 252(d) of this title shall also apply to a merger under this section.

(b) If the surviving corporation is a Delaware corporation, it may change its corporate name by the inclusion of a provision to that effect in the resolution of merger adopted by the directors of the parent corporation and set forth in the certificate of ownership and merger, and upon the effective date of the merger, the name of the corporation shall be so changed.

(c) The provisions of Section 251(d) of this title shall apply to a merger under this section, and the provisions of Section 251(e) shall apply to a merger under this section

in which the surviving corporation is the subsidiary corporation and is a corporation of this State. Any merger which effects any changes other than those authorized by this section or made applicable by this subsection shall be accomplished under the provisions of Section 251 or Section 252 of this title. The provisions of Section 262 of this title shall not apply to any merger effected under this section, except as provided in subsection (d) of this section.

(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the surviving corporation shall, within 10 days after the effective date of the merger, notify each stockholder of such Delaware corporation that the merger has become effective. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any such stockholder may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation payment of the value of his stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If during a period of 30 days after such period of 20 days the surviving corporation and any such objecting stockholder fail to agree as to the value of such stock, any such stockholder or the corporation may file a petition in the Court of Chancery as provided in subsection (c) of section 262 of this title and thereupon the parties shall have the rights and duties and follow the procedure set forth in subsections (d) to (j) inclusive of section 262.

(e) A merger may be effected under this section although one or more of the corporations parties to the merger is a corporation organized under the laws of a jurisdiction other than one of the United States; provided that the laws of such jurisdiction permit a corporation of such juris-

diction to merge with a corporation of another jurisdiction; and provided further that the surviving or resulting corporation shall be a corporation of this State.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

§ 262. Payment for stock or membership of person objecting to merger or consolidation

(a) When used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a non-stock corporation.

(b) The corporation surviving or resulting from any merger or consolidation shall within 10 days after the effective date of the merger or consolidation, notify each stockholder of any corporation of this State so merging or consolidating who objected thereto in writing and whose shares either were not entitled to vote or were not voted in favor of the merger or consolidation, and who filed such written objection with the corporation before the taking of the vote on the merger or consolidation, that the merger or consolidation has become effective. Such notice shall likewise be given to each stockholder whose corporation approved the merger or consolidation pursuant to section 228 of this title without a meeting of its stockholders and who either did not, or had no right to, consent in writing to such merger or consolidation. If any such stockholder shall within 20 days after the date of mailing of the notice demand in writing, from the corporation surviving or resulting from the merger or consolidation, payment of the value of his stock, the surviving or resulting corporation shall, within 30 days after the expiration of the period of 20 days,

pay to him the value of his stock on the effective date of the merger or consolidation, exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation.

(c) If during a period of 30 days following the period of 20 days provided for in subsection (b) of this section, the corporation and any such stockholder fail to agree upon the value of such stock, any such stockholder, or the corporation surviving or resulting from the merger or consolidation, may, by petition filed in the Court of Chancery within four months after the expiration of the period of 30 days, demand a determination of the value of the stock of all such stockholders by an appraiser to be appointed by the Court.

(d) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the corporation, which shall within ten days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the corporation. If the petition shall be filed by the corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the corporation and to the stockholder shown upon the list at the addresses therein stated, and notice shall also be given by publishing a notice at least once at least one week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware. The Court may direct such additional publication of notice as it deems advisable. The forms of the notices by mail and by publication shall be approved by the Court.

(e) After the hearing on such petition the Court shall determine the stockholders who have complied with the provisions of this section and become entitled to the valuation of and payment for their shares, and shall appoint an appraiser to determine such value. Such appraiser may examine any of the books and records of the corporation or corporations the stock of which he is charged with the duty of valuing, and he shall make a determination of the value of the shares upon such investigation as to him seems proper. The appraiser shall also afford a reasonable opportunity to the parties interested to submit to him pertinent evidence on the value of the shares. The appraiser, also, shall have such powers and authority as may be conferred upon masters by the rules of the Court of Chancery or by the order of his appointment.

(f) The appraiser shall determine the value of the stock of the stockholders adjudged by the Court of Chancery to be entitled to payment therefor and shall file his report respecting such value in the office of the Register in Chancery and notice of the filing of such report shall be given by the Register in Chancery to the parties in interest. Such report shall be subject to exceptions to be heard before the Court both upon the law and facts. The Court shall by its decree determine the value of the stock of the stockholders entitled to payment therefor and shall direct the payment of such value, together with interest, if any, as hereinafter provided, to the stockholders entitled thereto by the surviving or resulting corporation upon the transfer to it of the certificates representing such stock, which decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other state.

(g) At the time of appointing the appraiser or at any time thereafter the Court may require the stockholders who

demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, and if any stockholder fails to comply with such direction the Court may dismiss the proceedings as to such stockholder.

(h) The cost of any such appraisal, including a reasonable fee to and the reasonable expenses of the appraiser, but exclusive of fees of counsel or of experts retained by any party, may on application of any party in interest be determined by the Court and taxed upon the parties to such appraisal or any of them as appears to be equitable, except that the cost of giving the notice by publication and by registered mail hereinabove provided for shall be paid by the corporation. The Court may, on application of any party in interest, determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto.

(i) Any stockholder who has demanded payment of his stock as herein provided shall not thereafter be entitled to vote such stock for any purpose or be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation) unless the appointment of an appraiser shall not be applied for within the time herein provided, or the proceeding be dismissed as to such stockholder, or unless such stockholder shall with the written approval of the corporation deliver to the corporation a written withdrawal of his objections to and an acceptance of the merger or consolidation, in any of which cases the right of such stockholder to payment for his stock shall cease.

(j) The shares of the surviving or resulting corporation into which the shares of such objecting stockholders would

have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

(k) This section shall not apply to the shares of any class or series of a class of stock, which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation is to be acted on, were either (1) listed on a national securities exchange, or (2) held of record by more than 2,000 stockholders, unless the certificate of incorporation of the corporation issuing such stock shall otherwise provide; nor shall this section apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of Section 251 of this title. This subsection shall not be applicable to shares of any class or series of a class of stock of a constituent corporation if under the terms of a merger or consolidation pursuant to Section 251 or Section 252 of this title the holders thereof are required to accept for such stock anything except (a) shares of stock or shares of stock and cash in lieu of fractional shares of the corporation surviving or resulting from such merger or consolidation; or (b) shares of stock or shares of stock and cash in lieu of fractional shares of any other corporation, which at the effective date of the merger or consolidation will be either (1) listed on a national securities exchange or (2) held of record by more than 2,000 stockholders; or (c) a combination of shares of stock or shares of stock and cash in lieu of fractional shares as set forth in (a) and (b) of this subsection.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

Amendments to Sections 253 and 262 of the
Delaware Corporation Law
as of April 24, 1976

Section 2. Amend § 253(d), Subchapter IX, Chapter 1, Title 8, Delaware Code, by striking said subsection (d) in its entirety and substituting in lieu thereof a new subsection (d) to read as follows:

"(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this Section is not owned by the parent corporation immediately prior to the merger, the stockholders of the subsidiary Delaware corporation party to the merger shall have appraisal rights and the surviving corporation shall comply with the provisions of subsection (b)(2) of § 262 of this Title. Thereafter, the surviving corporation and the stockholders shall have such rights and duties and shall follow the procedures set forth in subsections (c) to (j), inclusive, of § 262 of this Title."

Section 3. Amend § 262(a), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (a) in its entirety and substituing in lieu thereof a new subsection (a) to read as follows:

"(a) Appraisal rights under this Section shall be available only for the shares of any stockholder who has complied with the provisions of subsection (b) of this Section and has neither voted in favor of the merger nor consented thereto in writing pursuant to § 228. When used in this Section, the word 'stockholder' means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words 'stock' and 'share' mean and include what is ordinarily meant by those words

and also membership or membership interest of a member of a non-stock corporation."

Section [redacted] § 262(b), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (b) in its entirety and substituting in lieu thereof a new subsection (b) to read as follows:

"(b) Appraisal rights under this Section shall be determined as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this Section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders entitled to such appraisal rights that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this Section. Each stockholder electing to demand the appraisal of his shares under this Section shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares; provided, however, that such demand must be in addition to and separate from any proxy or vote against the merger. Within 10 days after the effective date of such merger or consolidation, the surviving corporation shall notify each stockholder of each constituent corporation who has complied with the provisions of this subsection and has not voted in favor of or consented to the merger or consoli-

dation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this Chapter, the surviving corporation, either before the effective date of the merger or within 10 days thereafter, shall notify each of the stockholders entitled to appraisal rights of the effective date of the merger or consolidation that appraisal rights are available for any or all of the shares of the constituent corporations. A copy of this Section shall be included in the notice. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation the appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares."

Section 5. Amend § 262(c), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (c) in its entirety and substituting in lieu thereof a new subsection (c) to read as follows:

"(c) Within 120 days after the effective date of the merger or consolidation, the corporation or any stockholder who has complied with the provisions of subsections (a) and (b) hereof and who is otherwise entitled to appraisal rights under this Section, may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any

time within 60 days after the effective date of the merger or consolidation, any stockholder shall have the right to withdraw his demand for appraisal and to accept the terms offered upon the merger or consolidation."

Section 6. Amend § 262(e), Subchapter IX, Chapter 1, Title 8, Delaware Code, by striking said subsection (e) in its entirety and substituting in lieu thereof a new subsection (e) to read as follows:

"(e) After the hearing on such petition, the Court shall determine the stockholders who have complied with the provisions of this Section and who have become entitled to appraisal rights under this Section. The Court may require the stockholders who demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder."

Section 7. Amend § 262(f), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (f) in its entirety and substituting in lieu thereof a new subsection (f) to read as follows:

"(f) After the determination of the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger. Upon application by any stockholder entitled to participate in the appraisal proceeding or by the corporation, the Court may, in its discretion, permit discovery or other pretrail proceedings and may proceed to trial upon the appraisal prior

to the final determination of those other stockholders who have complied with this Section. Any stockholder whose name appears on the list filed by the corporation pursuant to subsection (d) of this Section and who has submitted his certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until the Court shall determine that he is not entitled to appraisal rights under this Section."

Section 8. Amend § 262(g), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (g) in its entirety and substituting in lieu thereof a new subsection (g) to read as follows:

"(g) The Court shall direct the payment of the appraised value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto upon the surrender to the corporation of the certificates representing such stock. The Court's decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other State."

Section 9. Amend § 262(h), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (h) in its entirety and substituting in lieu thereof a new subsection (h) to read as follows:

"(h) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon the application of any party in interest, the Court shall determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto. In making its determination with respect to

interest, the Court may consider all relevant factors, including the rate of interest which the corporation has paid for money it has borrowed, if any, during the pendency of the proceeding. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rate against the value of all of the shares entitled to an appraisal."

Section 10. Amend § 262(i), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (i) in its entirety and substituting in lieu thereof a new subsection (i) to read as follows:

"(i) Any stockholder who has demanded his appraisal rights as provided in subsection (b) of this Section shall thereafter neither be entitled to vote such stock for any purpose nor be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (c) of this Section, or if such stockholder shall deliver to the corporation a written withdrawal of his demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (c) of this Section or thereafter with the written approval of the corporation, then the right of such stockholder to appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder with-

out the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just."

Section 11. Amend § 262(k), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (k) in its entirety and substituting in lieu thereof a new subsection (k) to read as follows:

"(k) Unless otherwise provided in the certificate of incorporation of the corporation issuing such shares, no appraisal rights under this Section shall be available for the shares of any class or series of stock which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (1) listed on a national securities exchange or (2) held of record by more than 2,000 stockholders. No appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this Title."

Section 12. Amend § 262, Subchapter IX, Chapter 1, Title 8, Delaware Code by adding thereto a new subsection to be designated as subsection (l) to read as follows:

"(l) Notwithstanding the provisions of subsection (k) of this Section, appraisal rights under this Section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to § 251 or § 252 of this Title to accept for such stock anything except (1)

shares of stock of the corporation surviving or resulting from such merger or consolidation; (2) shares of stock of any other corporation which at the effective date of the merger or consolidation will be either listed on a national securities exchange or held of record by more than 2,000 shareholders; (3) cash in lieu of fractional shares of the corporations described in clauses (1) and (2) of this subsection; or (4) any combination of the shares of stock and cash in lieu of fractional shares described in clauses (1), (2) and (3) of this subsection."

Appendix B—Opinion of the District Court.

S. William Green, et al.,
Plaintiffs,

v.

Santa Fe Industries, Inc., et al.,
Defendants.
No. 74 Civ. 3915 CLB.

United States District Court,
S. D. New York.
March 27, 1975.

Leventritt, Lewittes & Bender by Sidney Bender, New York City, for plaintiffs.

Rogers & Wells, New York City by William R. Glendon and Guy C. Quinlan, New York City, for defendants Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc. and Kirby Lumber Corp.

Davis, Polk & Wardwell by S. Hazard Gillespie, James W. B. Benkard, and Charles R. Morgan, New York City, for defendant Morgan Stanley & Co.

Memorandum and Order

Brieant, District Judge.

Plaintiffs seek to maintain this purported class action on behalf of all of the former shareholders of Kirby Lumber Corporation ("Kirby"), a Delaware corporation, who were offered or received cash for their shares when Kirby and Forest Products, Inc. ("FPI") were merged. Plaintiffs also sue derivatively to enfore the rights of Kirby as it existed prior to the merger (hereinafter "Old Kirby").

Jurisdiction is premised on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa; this Court's jurisdic-

tion depends, therefore, upon the existence of a cognizable claim under Rule 10b-5. Plaintiffs also assert that this Court has pendent jurisdiction over related claims of the defendants' breach of their fiduciary duties. The complaint asserts jurisdiction by reason of diversity of citizenship, but complete diversity does not exist, as is conceded in ¶ 1 of the first amended complaint.

Defendants moved for an order pursuant to Rules 12(b)(1), and (6), F.R.Civ.P., dismissing the amended complaint for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted. Alternatively, defendants seek dismissal of the amended complaint for failure to satisfy Rule 9(b), F.R.Civ.P., because it does not state the circumstances constituting the claimed fraud with sufficient particularity.

The amended complaint shows that defendant Santa Fe Industries, Inc. owns all of the capital stock of Santa Fe Natural Resources, Inc., which, in turn, owned approximately 95% of the voting shares of Old Kirby. On July 11, 1974, Santa Fe Resources caused FPI to incorporate in Delaware. On July 29, 1974, FPI issued 1,000 shares [all] of its stock to Santa Fe Resources and received in return 474,675½ shares of Kirby which constituted approximately 95% of Kirby's shares, and all of those shares then owned by Santa Fe Resources. FPI also received $3,798,675.00 in cash and assumed expenses arising as a result of the contemplated merger of FPI and Kirby to form New Kirby. On July 30, 1974, the board of directors of FPI, the same persons who comprised the board of directors of Santa Fe Resources, adopted a resolution, pursuant to § 253 of the Delaware Corporation Law, that state's short-form merger statute, providing that FPI be merged into Kirby with Kirby surviving the merger. Shareholders of Old Kirby, other than FPI, would become entitled to $150.00 in cash per Kirby share held, and would cease being shareholders of Kirby effective immediately. On the next day the cus-

tomary Certificate of Ownership and Merger was filed with the Secretary of State of the State of Delaware, and the merger became effective, thereby extinguishing, or "freezing out" the minority shareholders of Kirby.

On August 1, 1974, New Kirby mailed to each former minority shareholder a notice of merger and an information statement consisting of 33 pages and supplementary exhibits. The information statement contained the terms of the plan of merger, a statement of Kirby's income, appraisals of the value of Kirby's stock and its assets, and a history of the prior dealings between Kirby and Santa Fe Industries and its affiliates. Exhibit C attached to the information statement is a copy of a letter from defendant Morgan, Stanley & Co. in which Morgan, Stanley, after consideration of Kirby's audited financial statements for the five years ending December 31, 1973, its unaudited financial statements for the four-month period ending April 30, 1974, its five-year forecast for 1974-78, and appraisals of Kirby's properties and mineral rights, placed a value on the minority shareholders' stock at $125.00 a share, adjusting for the assumption that Kirby's shares were broadly distributed and freely traded at prices within the range of prices typical of similar publicly held companies. The information statement also advised the minority shareholders that they could elect not to accept the terms of the offer, and instead seek a judicial appraisal in Delaware of the value of their shares. The information statement clearly described the time limitations within which the dissenting shareholders were to note their objection, and the time within which the appraisal action was to be commenced; it also included the text of the Delaware appraisal statute, Del.Gen.Corp.Law, § 262.

In their complaint, plaintiffs allege that the merger, its statutory means of effectuation and the cash exchange offered, constituted a "device, scheme or artifice to defraud" in violation of Rule 10b-5. Plaintiffs contend that, with

knowledge that the $150.00 a share offer understated the value of the physical assets of Kirby and therefore did not represent the true value of Kirby shares, Kirby and the Santa Fe affiliates obtained and submitted to the minority shareholders the $125.00 a share valuation from Morgan, Stanley "in order to lull the minority stockholders into erroneously believing (sic) that defendants were generous." (Complaint, ¶ 9). It is alleged further that Morgan, Stanley assisted knowingly and facilitated the fraud.

Plaintiffs' allegations have two distinct aspects. First, it is alleged that the means of effectuating this merger operated as a fraud on the minority shareholders in that the merger was consummated for the benefit of the majority shareholders, without any justifiable business purpose, except to freeze out the minority, and was effected without prior notice to the minority shareholders. Second, plaintiffs allege that the low valuation placed on their shares in the cash exchange offer segment of the merger transaction was in itself a fraud actionable under Rule 10b-5.

Plaintiffs' attack upon the Delaware short-form merger procedure based, as it is, upon Rule 10b-5 is without merit. The General Corporation Law of the State of Delaware permits a parent corporation to merge with another corporation, 90% of whose shares are owned by the parent, by executing and filing a certificate of ownership and merger together with a copy of the resolution of the board of directors of the parent. Del.Gen.Corp.Law, § 253 (a). *See generally,* N.Y.B.C.L., § 905 (McKinney's Consol. Laws, c. 4, Supp.1974); Stauffer v. Standard Brands Incorporated, 41 Del. Ch. 7, 187 A.2d 78 (Del.Sup.Ct.1962). The resolution of the board of directors may provide that minority shareholders are to receive cash in payment for their shares in the subsidiary although this has the effect of causing these shareholders to make a forced sale. See Vine v. Beneficial Finance Company, 374 F.2d 627 (2d Cir. 1967). Plaintiffs did not have a vested right to remain

shareholders of Kirby. Coyne v. Park & Tilford Distillers Corporation, 37 Del.Ch. 558, 146 A.2d 785 (Del.Ch.1958), aff'd, 38 Del.Ch. 514, 154 A.2d 893 (Del.Sup.Ct.1959); Matter of Willcox v. Stern, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401 (1966). The corporation law of a state may permit minority shareholders to be "frozen out" or to be "frozen in." Garzo v. Maid of the Mist Steamboat Co., 303 N.Y. 516, 104 N.E.2d 882 (1952). The Delaware corporation law does not require that the merger be effected for a business purpose. The statute reflects the public policy of Delaware with respect to rights of splinter interests in corporations. The Court does not view Rule 10b-5 as requiring a federal district court to analyze the motives of corporate directors, at least not in the absence of actual fraud and deceit. See Grimes v. Donaldson, Lufkin & Jenrette, Inc., Fed.Sec.L.Rep., ¶ 94,722 (N.D.Fla.1974); *cf.* Bryan v. Brock & Blevins Co., Inc., 490 F.2d 563 (5th Cir. 1974). "[T]he very purpose of the [Delaware short-form merger] statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise." Stauffer v. Standards Brands Incorporated, *supra,* 187 A.2d 80. See generally Borden, "Going Private—Old Tort, New Tort or No Tort?", 49 N.Y.U.L. Rev. 987 (1974).

When a merger is effected under this statute and all of the subsidiary's shares are not owned by the parent corporation, the merger statute requires that the surviving corporation *"within 10 days after the effective date* of the merger, notify each shareholder . . . that the merger has become effective," Del.Gen.Corp.Law, § 253(d) (emphasis added); Carl Marks & Co. v. Universal City Studios, Inc., 233 A.2d 63 (Del.Sup.Ct.1967). It is not contended that Kirby failed to comply with this notice requirement, rather it is argued that the anti-fraud provisions of the 1934 Act require prior notice and disclosure to the minority shareholders. The primary objective of Rule 10b-5 is to impose

a duty of disclosure upon a corporation and its controlling persons. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). That objective is to be achieved in conjunction with the state corporate law. This Court does not regard Rule 10b-5 as an omnibus federal corporation law having such broad reach as to modify the notice requirements of the Delaware merger statute, or prevent Delaware, in its legislative wisdom, from providing a means by which a majority can exclude a minority from the corporation's future affairs, so long as due process is satisfied, as it is here, by the appraisal procedures.

Plaintiffs contend further that the corporate defendants knowingly obtained an appraisal from defendant Morgan, Stanley which undervalued the worth of their Kirby stock so drastically as to be a fraud within the purview of Rule 10b-5. Plaintiffs value their shares at a minimum of $772.00 each, basing this figure on the *pro rata* value of Kirby's physical assets. For purposes of this motion the Court accepts plaintiffs' claimed valuation, although the propriety of using the liquidation value of Kirby's physical assets as the sole basis for determining the true worth of the shares owned by the minority shareholders is at least questionable. See In re Olivetti Underwood Corporation, 246 A.2d 800, 803 (Del.Ch. 1968); Application of Delaware Racing Association, 213 A.2d 203 (Del.Sup.Ct. 1965).

Accepting plaintiffs' valuation, the amended complaint, upon its face, fails to allege a course of fraudulent conduct.[1] In paragraph seven of their complaint, plaintiffs acknowledged that their valuation is based upon information provided by the corporate defendants in the merger information statement. The appraisal made by

[1] On oral argument, plaintiffs conceded that if the differential between price and true value was so slight that reasonable minds could differ, no action would lie under Rule 10b-5.

defendant Morgan, Stanley details the information upon which it relied in computing the value of the minority's shares in Kirby. Among the considerations relied upon by Morgan, Stanley were the values of Kirby's physical assets provided by Appraisal Associates and Riggs and Associates. The opinions of the latter two firms were appended to the merger information statement as Exhibits D and E, and the entire report of Appraisal Associates was available for inspection at the offices of Santa Fe Resources. The appraisal opinions, and detailed financial information, were provided for the minority shareholders' use in evaluating the merits of the cash exchange offer and in determining whether to seek their appraisal rights as dissenting shareholders.

Without passing upon the proper valuation of the Kirby shares, it is noteworthy that the information statement divulged the history of purchases of Kirby stock by the Santa Fe affiliates. Following the paradigm of "going private" transactions, an affiliate of Santa Fe made a tender offer for the shares of Kirby in 1967 and acquired 27,979½ shares at $65.00 per share. In the period from 1968 through 1973, Santa Fe affiliates purchased shares at prices ranging from $65.00 to $92.50 per share. None of the Santa Fe affiliates had acquired any Kirby stock since October 1973. The history of Santa Fe's affiliates' prior purchases provided plaintiffs with another basis of comparison for evaluating the merits of the exchange offer.

The complaint demonstrates merely that the parties to this action differ in their computation of the fair value of plaintiffs' shares. Whatever the information statement indicates about the fair value of plaintiffs' shares, the value of the physical assets "was discernible, as plaintiff[s] discerned it." Tanzer Economic Associates, Inc. v. Haynie, 388 F. Supp. 365, 369 (S.D.N.Y. 1974).

See also, Spiegler v. Wills, 60 F.R.D. 681 (S.D.N.Y. 1973). The inadequacy of the offering price, standing alone, does not demonstrate bad faith or overreaching on the part of the controlling interests. See Muschel v. Western Union Corporation, 310 A.2d 904 (Del.Ch.1973).

In Dreier v. The Music Makers Group, Inc. (1973-74) CCH Fed.Sec.L.Rep ¶ 94,406 (S.D.N.Y. February 20, 1974), a suit alleging a violation of Rule 10b-5 in connection with the merger of a publicly held corporation, The Music Makers Group, Inc., into a privately owned company, Leigh Group, Inc., effectuated by the voting power of Leigh Group, Inc., the majority shareholders of Music Makers Group, Inc., the Court dismissed the amended complaint holding that

> "non-disclosure remains an essential element in any section 10(b)-Rule 10b-5 action. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). The instant complaint does not allege any non-disclosure in connection with the merger; the treatment of the minority shareholders may well have been grossly unfair but it was completely open. Under these circumstances plaintiff's remedy is a state court action for appraisal pursuant to the Delaware Corporation Law." *Id.,* at 95,410. *Accord,* Popkin v. Bishop, *supra;* Kaufmann v. Lawrence, 386 F.Supp. 12 (S.D.N.Y.1974)

If adequate disclosure is made, "[u]nderlying questions of the wisdom of [merger freeze-out] transactions or even their fairness become tangential at best to federal regulation." Popkin v. Bishop, *supra,* 464 F.2d 720. See also, Armour and Company v. General Host Corporation, 296 F.Supp. 470 (S.D.N.Y.1969).

It was for each shareholder to determine, on the basis of the information provided, whether the price offered was adequate or whether he should seek a judicial appraisal. The instant complaint fails to allege an omission,

misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer. *Cf.* Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y.1974).

At least, if full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5. Support for this proposition is found in the Securities and Exchange Commission's ("SEC") own estimate of the reach and the limitations of existing regulations in dealing with "going private" transactions. The interpretation propounded "by an agency charged with the administration of a statute, while not conclusive, is entitled to substantial weight." Zeller v. Bogue Electric Manufacturing Corporation, 476 F.2d 795 (2d Cir.), cert. denied, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973). The SEC has promulgated proposed rules which would subject such transactions to comprehensive regulation. See Proposed Rules 13e-3A and 13e-3B, 2 Fed. Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. Notably, Proposed Rule 13e-3B(a) would make unlawful a shareholder freezeout transaction unless the transaction has "a valid business purpose" other than getting rid of a minority which might or does impede the will of the majority; and "the terms of [the] transaction, including any consideration to be paid to any security holder, are fair."

Another proposed SEC regulation would require, notwithstanding the provisions of a state's corporate law, that notice of the terms of any freeze-out transaction be sent to shareholders no later than 20 days prior to "authorization" of the transaction. Proposed Rule 13e-3A(c)(1). In addition to other disclosure requirements, both of the proposed rules would require that, for the consideration paid to be deemed fair, it must exceed the value placed on the securities by "two qualified independent persons." Proposed Rule 13e-3A(c)(2).

Implicit in the Commission's expressed intent to enact these or similar rules is the conclusion, which this Court shares, that existing rules, including Rule 10b-5, do not reach the acts here complained of.

Assuming *arguendo* that the merger information statement did not constitute adequate disclosure, the amended complaint does not demonstrate a causal connection between the alleged deception and plaintiffs' damages. Plaintiffs did not tender their shares for cancellation and payment pursuant to this merger plan. On August 1, 1974, the information statement was mailed to the minority shareholders. On August 21, 1974, the plaintiffs made a demand for an appraisal of their shares pursuant to Delaware statute, but, by letter dated September 9, 1974, they purported to withdraw this demand. On September 10, 1974, plaintiffs commenced this action. From the outset, plaintiffs recognized the alleged deception and did not rely upon it.

In a freeze-out merger, reliance need not be shown, Vine v. Beneficial Finance Company, *supra,* 374 F.2d 635; however, there must be some causal connection between the wrong done and the harm suffered. See Schlick v. Penn-Dixie Cement Corporation, 507 F.2d 374 (2d Cir. 1974); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974). In *Vine, supra,* although finding that no misrepresentation was made to the minority shareholders in a short-form merger, and that, therefore, there could be no reliance in the traditional sense, the Court found an actionable 10b-5 claim on the basis of misrepresentations made in the course of the parent company's acquisition of the shares needed to effect the short-form merger. See also, Voege v. American Sumatra Tobacco Corporation, 241 F.Supp. 369 (D.Del. 1965). No allegation is made here that the Santa Fe affiliates acquired their dominant interest by means of a fraud. In sum, the instant complaint fails to satisfy even the relaxed standard

of causation which must be shown to sustain an action as a "forced seller" under Rule 10b-5.

In finding that there is no causal connection, it may be added that the Court is not applying a standard of "but for" causation and does not view the Santa Fe affiliates as being immune from suit merely because the resulting merger could be effectuated without any action by the minority. See Swanson v. American Consumer Industries, Inc., 415 F.2d 1326 (7th Cir. 1969); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385, n. 7, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); *cf.* Kraficisn v. LaSalle Madison Hotel Co., (1972-73) CCH Fed.Sec.L.Rep. ¶ 93,586 (N.D.Ill. 1972). Rather, the Court finds that these plaintiffs in their complaint fail to allege that they relied to their detriment on the alleged misrepresentation and were injured thereby.

For the foregoing reasons, it appears that the amended complaint fails to state a claim under the federal securities laws. Since the complaint fails to state a federal claim, exercise of pendent jurisdiction to adjudicate common law claims of breach of fiduciary duty is inappropriate. Kavit v. A. L. Stamm & Co., 491 F.2d 1176 (2d Cir. 1974).

Diversity jurisdiction will not lie in the absence of complete diversity of citizenship between all parties plaintiff and all parties defendant. Strawbridge v. Curtiss, 3 Cranch 267, 2 L.Ed. 435 (U.S. 1806). The amended complaint states (¶ 1) that there is no diversity of citizenship between the plaintiffs and defendant Morgan, Stanley.

Plaintiffs lack standing to maintain this action derivatively in the right of Old Kirby. Under Delaware law, as a result of a merger, the derivative rights of the merged subsidiary pass to the surviving corporation. Bokat v. Getty Oil Co., 262 A.2d 246 (Del.Sup.Ct. 1970); Braasch v. Goldschmidt, 41 Del. Ch. 519, 199 A.2d 760 (Del. Ch. 1964); Heit v. Tenneco, Inc., 319 F.Supp. 884 (D.Del.

1970). See also, Voege v. Ackerman, 364 F.Supp. 72 (S.D.N.Y. 1973). Assuming however, that the plaintiffs retain their rights as shareholders of Old Kirby after the merger, a derivative recovery would be an inappropriate remedy. If plaintiffs were to be successful on their derivative claims, the benefits would enure either to a corporation that is no longer functioning or to the entire class of Kirby shareholders, including the Santa Fe affiliates who are the purported malefactors. Vine v. Beneficial Finance Company, *supra,* 374 F.2d 637; de Haas v. Empire Petroleum Company, 300 F.Supp. 834 (D.Colo. 1969). See also, Johnson v. American General Insurance Company, 296 F. Supp. 802 (D.D.C. 1969).

This complaint has been amended once. Plaintiffs on the oral argument of this motion show no facts or contentions which they could assert if given further leave to serve a second amended complaint. In the absence of any such showing, this motion is granted, and the amended complaint is dismissed.

So ordered.

Appendix C—Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 157—September Term, 1975.

(Argued November 5, 1975 Decided February 18, 1976.)

Docket No. 75-7256

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of Louis A. Green, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

—against—

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN STANLEY & Co.,

Defendants-Appellees.

Before:

MEDINA, MOORE and MANSFIELD,

Circuit Judges.

Appeal from an order and judgment of the United States District Court for the Southern District of New York, Charles L. Brieant, Jr., *Judge.*

S. William Green and others, shareholders of Kirby Lumber Corporation, appeal from an order and judgment dismissing their complaint for failure to allege subject matter jurisdiction and for failure to state a claim for relief. Opinion below, 391 F.Supp. 819. Affirmed as to defendant Morgan Stanley & Co., reversed as to the other defendants.

AARON LEWITTES, New York, N.Y. (Sidney Bender and Leventritt Lewittes & Bender, New York, N.Y., on the brief), *for Plaintiffs-Appellants.*

WILLIAM R. GLENDON, New York, N.Y. (Guy C. Quinlan, Gene M. Bauer and Rogers & Wells, New York, N.Y., on the brief), *for Defendants-Appellees Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc., and Kirby Lumber Corporation.*

S. HAZARD GILLESPIE, New York, N.Y. (James W. B. Benkard, Charles R. Morgan and Davis, Polk & Wardwell, New York, N.Y., on the brief), *for Defendant-Appellee Morgan Stanley & Co.*

MEDINA, *Circuit Judge:*

S. William Green and others, shareholders of Kirby Lumber Corporation, individually and as such shareholders, suing on behalf of themselves and for the benefit of the corporation and for the class of all other minority shareholders of Kirby, appeal from an order of Judge Charles L. Brieant, Jr. in the Southern District of New York, dismissing their amended complaint for failure of subject matter jurisdiction and for failure to state a claim on which relief can be granted. The opinion below is reported at 391 F.Supp. 849.

This important, interesting and complicated case involves a claim, framed in a double aspect, by minority shareholders and the class they represent arising out of S.E.C. Rule 10b-5 concerning the purchase and sale of securities in interstate commerce in the setting of a short-form merger under the laws of the State of Delaware. These laws permit a majority of 90% or more of the shareholders of a Delaware corporation to squeeze out the minority without giving prior notice of the intention to do so, without any statement of a justifiable corporate reason for the merger and upon payment to the minority shareholders of an amount of dollars per share specified in the terms of the merger. The sole remedy of an objecting minority shareholder under these Delaware laws is to demand an appraisal of the value of his stock in a proceeding in the Delaware Court of Chancery.[1]

The double aspect of the claim asserted in the complaint is:

(1) that the Delaware procedure as applied to the facts of this case constitutes a "device, scheme, or artifice to defraud" because of the gross undervaluation by defendants of the shares the minority shareholders are forced to sell for $150 a share; and

(2) that without any misrepresentation or failure to disclose relevant facts, the merger itself constitutes a violation of Rule 10b-5 because the mulcting of the minority shareholders is accomplished by a breach by the majority

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[1] While the appraisal statute, Del. Code Ann. tit. 8 § 262 (1974) is silent on the exclusivity of the appraisal remedy, it is generally held exclusive as against one who complains of a short-form merger. See *Abelow* v. *Midstates Oil Corp.*, 41 Del. Ch. 145, 151, 189 A.2d 675, 679 (Sup. Ct. 1963); *Stauffer* v. *Standard Brands Inc.*, 41 Del. Ch. 7, 9-10, 187 A.2d 78, 80 (Sup. Ct. 1962). But see *Braasch* v. *Goldschmidt*, 41 Del. Ch. 519, 524, 199 A.2d 760, 764 (Ch. 1964).

of its fiduciary duty to deal fairly with the minority who in effect are the *cestuis* of the majority. This breach of fiduciary duty is the forcing of the minority to sell their stock at far less than it is worth against their will, and even without any opportunity to seek pre-merger relief from the courts, all for the enrichment of the majority who continue to hold their stock. All this is alleged to be done at the expense of the corporation without any corporate purpose justifying the expenditure.

Jurisdiction is based upon Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. Section 78aa, and exists only if the amended complaint contains allegations that on their face make out a case of fraud within the meaning of Section 10(b), 15 U.S.C. Section 78j(b) and S.E.C. Rule 10b-5, 17 C.F.R. 240.10b-5. We do not reach the pendent and diversity claims.

The judge and counsel for all parties wisely agreed, for the purposes of the motion to dismiss, to consider the entire Information Statement, including the letter of Morgan Stanley & Co. of June 24, 1974, and all the annexed Exhibits, Schedules and Appraisals, as part of the amended complaint. They also agreed to treat the allegation that the purpose of the merger was to freeze out the minority shareholders as a charge that this was not done for any justifiable corporate purpose. The subject is discussed on this basis in the opinion below. We would not have mentioned this subject had it not been for the fact that the defendants in a footnote on page 9 of their main brief make a halfhearted claim that by not mentioning the lack of business purpose in their main brief the appellants had "abandoned this position." We find no abandonment whatever of this very significant part of plaintiffs' claims. Appellants may have given this phase of their contentions less emphasis in order to keep Morgan Stanley & Co. in the case.

I

We do not write on a clean slate. The background of judicial decisions is truly formidable, especially as the opinions contain so many dicta that may be thought by some to be ambiguous and so many seemingly unnecessary digressions. Accordingly, we think it will be helpful to an understanding of this opinion as a whole if we refer at the outset, and before our outline of the facts, to the holdings of this Court on two of the law points crucial to the disposition of this appeal.

First. It seems to be thought that it is a complete defense to show that defendants did exactly what the laws of Delaware required in order to effecuate a short-form merger. Under Delaware law the sole remedy of the dissenting minority shareholders is the Delaware appraisal proceeding.[2] But it is settled law in the Second Circuit that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law." *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972). *See also Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Levine* v. *Biddle Sawyer Corp.,* 383 F.Supp. 618, 622 (S.D.N.Y. 1974). So, here, the principal if not the sole question we have to decide is whether or not plaintiffs have stated a claim arising out of Rule 10b-5. The legal reasoning supporting this holding is, we think, that the states have no power to preempt Congress in the creation of substantive rights and remedies arising from purchases and sales of securities in interstate commerce. Neither Delaware nor any other state may do more than create substantive remedies that are not preemptive or exclusive but must compete with other properly constituted remedies

[2] *See* note 1 *supra.*

in the market place where the most effective and least costly of those procedures may be expected to prevail. The remedies available to redress violations under the Securities Exchange Act are supplementary to those provided by the states and they may not be abrogated merely by the coincidental availablity of an alternate or corollary state remedy. Furthermore, the fact that a state has chosen to create a particular remedy for a particular injury in no way precludes the Congress from creating an additional form of relief for another injury. Thus, the fact that a shareholder claiming fraud both in the consummation of a merger not based on any justifiable corporate purpose and in the undervaluation of his shares may under state law only resort to an appraisal proceeding that merely ameliorates the undervaluation does not foreclose the right of the Congress and the federal courts to provide that claimant an additional right and remedy to redress any injury flowing from a fraud inherent in the merger itself.

Second. Another erroneous assumption is that in order to allege a claim under Rule 10b-5 there must be some showing of misrepresentation or lack of disclosure. This, is one of the grounds stated by Judge Brieant in the court below for his dismissal of the complaint. 391 F.Supp. 849, 854-55. But only subdivision (2) of 10b-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud other than and in addition to a failure to disclose or truthfully represent is also actionable:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

* * *

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

It must be that the failure to observe this broader scope of Rule 10b-5 led the court below to dismiss the complaint, even accepting "plaintiffs' claimed valuation" and assuming the truth of the allegations of the complaint to the effect that the stock was grossly undervalued and that there was no justifiable corporate reason for the merger. Our later review of the decisions of this Court on the subject of allegations under Rule 10b-5 of breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure will, we think, demonstrate that in such cases misrepresentation or lack of disclosure are not essential ingredients of the claim for relief by the minority. But, lest there be any lingering doubt on this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary.

As with other laws Rule 10b-5 must be interpreted and applied so as to accomplish the purpose for which it was intended. That this requires a generous reading is too obvious for comment. Since the time to which the memory of man runneth not to the contrary the human animal has been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the ordinary run of those willing and able to take unfair advantage of others are mere apprentices in the art

when compared with the manipulations thought up by those connected in one way or another with transactions in securities. This is especially true of schemes that seem to be absolutely safe but offer rich rewards. In these days when there are takeovers and tender offers galore, times when those who used to think of going public now think of becoming private again, it is especially important to give Rule 10b-5 its full scope. If this is to be done, the enforcement of the fiduciary duty owed by the majority to the minority in corporations large and small should not be overlooked.

At this stage of the proceedings in this case we need not concern ourselves with the federal rules to be formulated relative to the ascertainment of the true value of the shares now held by the minority nor the specific remedy to be applied should the plaintiffs prevail.

We also recognize that we are only dealing now with the allegations of the complaint, which we must assume to be true. The defendants may prove that there has been no breach of fiduciary duty by the majority. More of this later.

Without further discussion we think it is clear that the case relates to the purchase and sale of securities in interstate commerce,[3] that the plaintiffs are indeed forced sellers,[4] and that there is a causal relation between the alleged breach of fiduciary duty by the majority and the injury suffered by the complaining owners of the minority stock interest.

II

Prior to July 31, 1974, plaintiffs were minority shareholders of Kirby Lumber Co., a Delaware corporation. For

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[3] *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627, 634 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *Popkin* v. *Bishop*, 464 F.2d 714, 718 n. 8 (2d Cir. 1972).

[4] *Vine* v. *Beneficial Finance Co., supra,* at 635.

some years prior to the merger transactions involved here, approximately 95% of the capital stock of Kirby was owned by defendant Santa Fe Natural Resources ("Resources") which in turn is a wholly-owned subsidiary of defendant Santa Fe Industries, Inc. ("Santa Fe").

In July, 1974, Resources embarked upon a plan to effect a short-form merger pursuant to Section 253 of the Delaware Corporation Law, which permits a parent corporation owning at least 90% of the capital stock of a subsidiary to merge the parent and the subsidiary, upon approval by the parent's Board of Directors and shareholders. Accordingly, a fourth corporation, Forest Products, Inc. ("Forest Products"), was organized in July as a Delaware corporation. Resources transferred approximately 95% of the capital stock to Forest Products, together with cash and the assumption of certain liabilities, in exchange for all of Forest Product's capital stock.

Shortly thereafter, the board of Forest Products adopted a Section 253 merger resolution providing that Forest Products would be merged into Kirby, with Kirby as the surviving corporation. Since such a merger resolution may provide that all shares held by minority shareholders will be purchased for cash, and consent of the minority shareholders is not required, the resolution stipulated that the minority shareholders of Kirby would have the right to receive $150 per share or to seek appraisal for their stock, as permitted by the Delaware statute. The merger became effective on July 31, 1974. In accord with Delaware Corporation Law Section 253(b), "new" Kirby notified the shareholders of "old" Kirby of the merger and of their rights, and sent a detailed financial Information Statement regarding Kirby.

None of the plaintiffs tendered any of the stock of Kirby. Instead, on August 21, 1974, they made a demand for appraisal of their Kirby stock. On September

9 of that same year, however, they purported to withdraw that demand, and on September 10, they commenced this lawsuit.

The gravamen of their complaint, in which the prayer for relief is that the merger be rescinded, that plaintiffs be awarded money damages or such other and further relief as may be just, is that the short-form merger resulted in the acquisition of the minority shares at a "grossly undervalued price." That undervaluation, they claim, combined with the corporation's failure to disclose the merger to plaintiffs until after its completion, and the fact that, as they say, the merger was effected without any business purpose, constituted a manipulative and deceptive device in breach of Rule 10b-5 and a common law breach of the fiduciary duty owed to Kirby and its minority shareholders. Since an opinion from Appraisal Associates, contained in the Information Statement sent to plaintiffs, valued Kirby's land and timber at $320 million, plaintiffs contend that the appraisal of the minority shares should have been at least equal to $772 per share. The statement to the minority shareholders presented the alternative of cash amounting to $150 per share or a valuation by the courts if requested. The $150 per share was based upon the opinion of Morgan Stanley & Co. which concluded:

> Based on our studies as outlined above, and on the assumptions that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

This opinion was expressed in a letter of June 24, 1974, which in turn was based upon a detailed study of the business affairs of Kirby Lumber Corporation, including a review of financial statements and appraisals of the Company's properties as set forth in elaborate schedules attached to the Information Statement. All plaintiffs' claims with respect to the alleged "fraudulent" and "unconscionable" undervaluation of the stock are based upon what was thus disclosed to the shareholders prior to the merger in the Information Statement.

III

The Law

A

The Delaware Corporation Laws

Many years ago the State of Delaware through its legislature established a series of corporation laws thought to be favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the members of the legal profession located in Delaware. Many of these laws were copied in other states for similar purposes. Without making a long story of it, some of these laws were intended to facilitate the squeezing out of minority shareholders. Of these laws, the one with which we are principally concerned here made elaborate provisions for a short-form merger under Section 253 of the Delaware Corporation Law. The salient feature of this short-form merger was that a majority of 90% of the shareholders could eliminate the 10% minority without any vote of the shareholders, without prior notice to the minority shareholders, without any statement of corporate purpose and by fixing an amount to be paid

per share to the minority shareholders, who were given the option of selling their shares at the stipulated price or demanding an appraisal under the auspices of the Delaware Court of Chancery, pursuant to the terms of Section 262 of the Delaware Corporation Law. We are told that the avowed purpose of these laws was to wipe out the minority.[5] The Delaware courts have held that the sole remedy of the minority shareholders is to demand the appraisal and be paid the amount per share fixed by the appraisal.[6] No opportunity is afforded the minority shareholder in advance of the date when the merger becomes effective to apply to any court for injunctive relief to stop the merger, nor is there any provision for rescission or other relief.

The Delaware laws also permit a long-form merger in cases where the majority have control but not 90% of the stock. In such cases prior notice is required and an opportunity is afforded to apply to a court for injunctive relief. In this class of mergers a vote of the shareholders is necessary.

In the case of a short-form merger, if the majority decides to fix the price to be paid to the minority shareholders at a figure substantially less than the shares are worth and the merger becomes effective and the minority shareholders turn in their stock and receive from the corporation the amount stipulated to be paid, all in the absence of any stated corporate purpose, the corporation pays for the stock bought from the minority shareholders, the minority shareholders are squeezed out and the entire benefit of the transaction inures to the majority shareholders. The corporation receives no advantage, and may in

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[5] See *Stauffer* v. *Standard Brands Inc.*, 40 Del. Ch. 202, 178 A.2d 311, 314 (Ch. 1962), *aff'd,* 41 Del. Ch. 7, 187 A.2d 78 (Sup. Ct. 1962).

[6] See note 1 *supra.*

fact suffer detriment, and by the elimination of the shares of stock of the minority the majority's shares become more valuable. Plaintiffs claim this is just such a case.

B

Where a Breach of Fiduciary Duty by Majority Shareholders with Resulting Detriment to the Minority Is Alleged as in this Case, No Claim of Misrepresentation or Lack of Disclosure Is Required to Make Out a Case Under Rule 10b-5

The main thrust of the decision below is that to state a preliminary case under Rule 10b-5 there must be misrepresentation or lack of disclosure even in the pressence of a breach of fiduciary duty. We disagree. While the "fraud" at which 10b-5 is aimed obviously includes the classic examples of misrepresentation and nondisclosure inveighed against in *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964) and *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), it is by no means limited to that type of illegality. As the Court stated in *S.E.C.* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963), quoting from *Moore* v. *Crawford*, 130 U.S. 122, 128 (1888):

> Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.

The Court has previously made clear that Section 10(b) was not intended to be a panacea for all corporate ills and management wrongdoing, *Superintendent of Ins.* v. *Bankers Life and Casualty Co.*, 404 U.S. 6, 11-12 (1971). But it has also directed that "[s]ection 10(b) must be read

flexibly, not technically and restrictively." *Id.*, at 12. *See also A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 396-7 (2d Cir. 1967). We have followed that mandate.

In *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 (1969), we focused on the question whether improper self-dealing and breach of fiduciary duty by the majority, without more, constituted a violation of 10b-5. Answering that question in the affirmative, Judge Hays, writing for the majority, emphasized subdivision (3) of 10b-5 and held that a preliminary cause of action under that Rule had been stated. Breach of fiduciary duty and fraud on the *cestuis* and the corporation had been committed, on the facts as alleged, when Banff sold its shares to Aquitaine at an inordinately low price after the directors had learned of the important oil discovery and before that information had been made public, even though there had been neither misrepresentation nor failure to make any required disclosure to the minority. The decision echoes the well-established principles enunciated in *Pepper* v. *Litton*, 308 U.S. 295, 306-7 (1939), that directors and controlling shareholders are fiduciaries.

> Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

Id., at 306. When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders' interest for the sole purpose of feeding the pocketbooks of the controlling shareholders, such conduct goes beyond mere negligent mismanagement

and is properly cognizable as "an act, practice, or course of business which operates or would operate as a fraud * * *." The majority has abused its equitable powers by exercising them for the "aggrandizement, preference, or advantage of the fiduciary to the exclusion of the *cestuis.*" *Pepper* v. *Litton, supra,* at 311. *See also Drachman* v. *Harvey,* 453 F.2d 722, 736 (2d Cir. 1972) (*en banc*).

Our finding of fraud inherent in the freezing out of a splinter interest in the context of a "going private" transaction that lacks corporate purpose is not without scholarly or judicial support. *See, e.g., Bryan* v. *Brock & Blevins Co., Inc.,* 490 F.2d 563 (5th Cir.), *cert. denied,* 419 U.S. 844 (1974); *Voege* v. *American Sumatra Tobacco Corp.,* 241 F.Supp. 369, 375 (D. Del. 1965) ("Plaintiff at bar was the subject of deception for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find, according to the complaint, that the terms of the merger were designed to defraud her."); Borden, *Going Private—Old Tort, New York, or No Tort?* 49 N.Y.U. L. Rev. 987 (1974); Note, *Going Private,* 84 Yale L. J. 903 (1975); Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964).

Most recently in *Marshel* v. *AFW Fabric Corp.,* —— F.2d ——, Dkt. No. 75-7404 (2d Cir. February 13, 1976), we were faced with the question whether a merger lacking any justifiable corporate purpose and effected under the New York long-form merger statute might be challenged by minority shareholders under Rule 10b-5. Notwithstanding the absence of any allegation of misrepresentation or nondisclosure, we granted the shareholders' motion for a preliminary injunction against the proposed merger and held that a cause of action under Section 10(b) and Rule 10b-5 is stated "when controlling stockholders and direc-

tors of a publicly held corporation cause it to ex[illegible] corporate funds, to force elimination of minority stoc[illegible]ers' equity participation for reasons not benefiting the corporation but rather serving only the interests of the controlling stockholders * * *." Like the Delaware provisions, the New York merger statutes provide an appraisal remedy for the complaining minority shareholders. In addition, however, since prior shareholder approval is required in the instance of the long-form merger, the shareholders in *Marshel* were also afforded the opportunity to seek premerger injunctive relief. We regard the unavailability of this additional remedy in the case before us as further justification for the intervention of the federal courts to remedy any fraudulent conduct.

We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. We do not hold that the charge of excessively low valuation by itself satisfies the requirements of Rule 10b-5 because that is not the case before us.

C

Popkin v. *Bishop, 464 F.2d 714 (2d Cir. 1972) Is Distinguishable and the Ruling in that Case Impliedly Supports Our Decision in this Case*

Curiously enough both sides in the case before us rely upon *Popkin* as controlling. That was a long-form merger

case under the New York counterpart of the Delaware long-form merger law. There was no basis for a short-form merger as the majority control was 51.7%, far less than the 90% required for a short-form merger. Accordingly, prior shareholder approval of the merger was required and the minority interest was given an opportunity, prior to the consummation of the merger, to sue for injunctive relief to stop the merger. There was no showing of misrepresentation or lack of disclosure and, accordingly, the complaint was dismissed. The principal feature of *Popkin* that distinguishes it from the case before us is that in *Popkin* there was a corporate business purpose so strong as to be as a practical matter compelling. This purpose arose from a stipulation made in a prior New York state suit one of the principal terms of which was that the merger be consummated, evidently for the purpose of avoiding the possibility of future management misconduct. (464 F.2d at 716). Thus the court held that plaintiffs in *Popkin* had no Rule 10b-5 claim.

The reasoning of *Popkin* also supports the conclusion we reach here to the effect that the allegation of breach of fiduciary duty owing by the majority to the minority states a 10b-5 violation without a showing of misrepresentation or lack of disclosure. *Popkin* holds that the primary reason misrepresentation or lack of disclosure was required was that shareholder approval was necessary. "In the context of such transactions [*i.e.*, those for which shareholder approval is required], if federal law insures that shareholder approval is fairly sought and fully given, the principal federal interest is at an end." 464 F.2d at 720 [material supplied]. The plain implication is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresentation or lack of disclosure to make out a 10b-5 case. As the *Popkin* court stated,

> In many, if not most, corporate self-dealing transactions touching securities, state law does not demand prior shareholder approval. In those situations, it makes sense to concentrate on the impropriety of the conduct itself rather than on the "failure to disclose" it because full and fair disclosure in a real sense will rarely occur.

464 F.2d at 719. Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constitute the fraud, and not whether or not the majority determines to lay bare their real motives. If there is no valid corporate purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct. This is the substance of plaintiffs' reliance on *Popkin* here, and we agree.

It may well be that, in view of the fact that the majority's 51.7% control made it inevitable that minority opposition would be futile, any requirement of misrepresentation or lack of disclosure was illusory. Whether or not this criticism of *Popkin* is justified is, we think, for another day.

IV

The Allegations of the Amended Complaint Fail to State a Claim under Rule 10b-5 Against Morgan Stanley & Co.[7]

As we have already said, we do not now hold that an allegation of substantial undervaluation, standing alone, makes out a Rule 10b-5 case in a Delaware short-form

[7] Of course, the separate position of Morgan Stanley & Co. was not even discussed by Judge Brieant in his opinion as he held that no Rule 10b-5 case had been alleged against any of the defendants because of the absence of any allegation of misrepresentation or lack of disclosure.

merger setting. We deal here with the additional elements of lack of a justifiable corporate purpose for the merger and the fact that the Delaware law provides for no prior notice to the minority shareholders thus depriving them of the opportunity to apply for injunctive relief, as well as the allegations of undervaluation. Morgan Stanley & Co.'s involvement in the merger was strictly limited to the valuation of stock and to the compilation of a report detailing the company's financial status. There is no allegation that Morgan Stanley & Co. engaged in any misrepresentation or nondisclosure such as would support its liability under Rule 10b-5(2).

We find no intimation in the amended complaint or in any of the briefs that Morgan Stanley & Co. had anything whatever to do with the planning of the merger or that it had any knowledge as to whether or not there existed a justifiable corporate purpose for the merger. And, of course, Morgan Stanley & Co. cannot be, and has not been, charged with any responsibility for effectuating the procedural steps incidental to the merger or for implementing the Delaware law and its provision for shareholder notice only after the merger has become effective. Most importantly, Morgan Stanley & Co. has not been charged with participation in the majority shareholders' breach of fiduciary duty, a key element of the latter's 10b-5 liability.

Even with respect to the alleged undervaluation of the stock we think the conclusory allegations that Morgan Stanley & Co. acted willfully, as an accessory and as an aider and abettor in setting the value of the Kirby shares are plainly insufficient. The Information Statement itself, including the Morgan Stanley letter of June 24, 1974, and the Schedules and Exhibits attached to these documents, shows on its face that there was no wilful or other representation by Morgan Stanley & Co. that the Kirby shares should be valued at $150. All that Morgan Stanley & Co.

did, or was asked to do, was to assemble and present for the consideration of the Kirby management and the minority shareholders the data and information, including the price at which the shares would probably be publicly or privately traded, which would enable the minority shareholders to make an intelligent decision as to whether to surrender their stock in return for $150 a share or apply to the Delaware Court of Chancery for an independent valuation of the stock. It is not even alleged that Morgan Stanley & Co. had anything to do with the decision by the majority shareholders to fix the offering price at $150 a share, thereby adding an increment of $25 to the fair market value as appraised by Morgan Stanley & Co., perhaps in the interest of leading the minority shareholders to believe that the offer was a generous one. Finally, it is not alleged that Morgan Stanley & Co. received any benefit or unjustly profited in any direct or indirect manner by its appraisal.

A copy of the letter of Morgan Stanley & Co. of June 24, 1974, is set forth in the margin.[8] We think the refer-

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[8] Morgan Stanley & Co.
1251 Avenue of the Americas
New York, N.Y. 10020

June 24, 1974

Mr. John C. Davis
Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

Dear Mr. Davis:

You have asked that we furnish an opinion as to the present fair market value of a share of capital stock of Kirby Lumber Corporation ("Kirby" or the "Company"), a subsidiary of Sante Fe Natural Resources, Inc. We understand that 25,324.5 shares or approximately 5.1% of the Company's outstanding capital stock constitutes the minority interest.

In connection with our study of the Company for purposes of making our valuation, we have toured the Company's facilities and have had discussions with management regarding the

ence to "fair market value" in the first paragraph as well as the entire last paragraph of the letter is to current sales of shares of Kirby stock on some stock exchange, or otherwise, a subject in which the minority shareholders might be expected to be interested. The record is barren of any information on the subject of public or private trading in shares of this publicly owned stock. Nor do any dates of purchase and sale transactions appear in the record, except certain purchases by affiliates at prices ranging from $65 per share in 1968 to $90 per share in 1973 in one of the Exhibits attached to the Information Statement. We are inclined to suspect, in the absence of any statement on this point in the complaint or in the briefs, that the reason

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Company's business. We have been furnished with and have reviewed the Company's audited financial statements for the five years ended December 31, 1973, and the unaudited financial statements for the four-month period ending April 30, 1974. We have reviewed the Company's five-year forecast for the years 1974-1978 and have discussed it and the general future outlook for the Company with its management. Also, we have reviewed the written appraisals of the Company's properties and mineral rights which were separately performed by Appraisal Associates and Riggs and Associates.

We have studied the Company's financial position and its operating history and have made comparisons of such information with the financial position and operating histories of other companies in the forest products industry, the securities of which are publicly held and actively traded.

We have, in addition, considered such other matters and made such other studies as we considered necessary or pertinent.

Based on our studies as outlined above, and on the assumption that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

Very truly yours,

/s/ Morgan Stanley & Co.

for the estimate by Morgan Stanley & Co. was that there was no public or private market for the stock.

Thus, absent any claim that Morgan Stanley & Co. was in any way involved in planning or effectuating the merger, or that it shared in the alleged profiteering and faithless conduct of the majority shareholders, appellants' summary allegations that the Company participated in fraudulently undervaluing the minority shares fails to state a claim under Rule 10b-5.

V

Conclusion

The provisions of the Delaware corporation law relative to short-form mergers have been the subject of favorable and unfavorable comment for years. One of the Commissioners of the SEC has made a speech on the subject. The SEC has circulated certain proposed new rules.[9] Law professors, practicing lawyers and student editors of law reviews have had their say. We do not think it would be profitable to comment on any of this, except to say that we have read all this material and given it the consideration we think it deserves.

We have also refrained from comment on the remedy to be applied, in the event that plaintiffs succeed at the trial, or on the thorny subject of how in such event a proper valuation of the stock is to be made. These are questions proper for consideration at the trial level, after all the

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[9] Proposed Rules 13e-3A and 13e-3B, 2 Fed.Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. The proposed rules would subject short-form mergers and other share repurchase transactions to comprehensive regulation. Significantly, the rules would require that the issuer have a valid corporate purpose for any repurchase of minority shares in connection with a short-form merger and that the terms of such a transaction, including any consideration to be paid to the minority shareholders, be fair.

proofs are in. In view of the conclusions at which we have arrived, we do not reach the pendent or diversity claims.

With respect to defendant Morgan Stanley & Co. the order and judgment appealed from are affirmed. As to the other defendants the order and judgment appealed from are reversed.

MANSFIELD, *Circuit Judge* (Concurring):

I concur in Judge Medina's opinion holding that a short-form merger consummated without any legitimate corporate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5. By using the short-form merger device in this fashion the majority commits a wrong that extends beyond mere mismanagement of corporate affairs; the majority also breaches its duty as a fiduciary to deal fairly with the public investors, and, by acting unilaterally and without any advance notice, deprives them of the opportunity to seek relief based on the absence of any legitimate corporate purpose. The resulting merger amounts to a "manipulative or deceptive device or contrivance" which operates as a fraud on public stockholders of the type intended to be proscribed by § 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. Upon a showing that the merger had no legitimate corporate purpose, the district court should, if feasible, set it aside or, if the merger cannot effectively be voided,[1] award damages representing the difference between the fair buy-out price and the unfair, unilateral buy-out price set by the corporate insiders.[2] Such relief is not barred by the co-availability of state law remedies. *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 12 (1971); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972).

Inherent in the act of "going private" through a short-form merger is an enormous potential for abuse of the corporate insiders' fiduciary position with respect to the "frozen out" public shareholders. Essentially, by "going public" when the stock market is flourishing and squeezing out the public shareholders when the market is depressed, the majority is able to manipulate the sale and purchase of stock to its benefit and to the detriment of the public shareholders, depriving the latter involuntarily of their investment in the corporation, see Vorenberg, *Exclusiveness of the Dissenting Shareholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964), at a buy-out price unilaterally selected by the insiders, which they have every incentive to fix below the fair value of the public shareholders' interest. Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers,* 88 Harv. L. Rev. 297, 298 (1974).

The unfairness and conflicts of interests generated by "going-private" mergers have not been lost on the business

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[1] Ordinarily in providing relief a court faces difficulties in setting aside a consummated merger. However, in the case of a short-form merger, the sole functional difference between the pre- and post-merged entities is the absence of the "frozen-out" public shareholders from the latter. Therefore, unless the parties materially and in good faith had relied upon the merger, the court in equity should be able to undo the unlawful effects of the short-form device by restoring the public shareholders to their pro-rata share of ownership.

[2] As Judge Medina notes, for purposes of this appeal we are to assume that the $150 per share offered by Kirby to the public shareholders is inadequate and that the correct buy-out price equals $772 per share, a sum derived by a pro-rata division of Kirby's appraised assets. Should the district court decide that legal and not equitable relief is appropriate here, it, of course, would be required to determine a fair buy-out price, cf. *Knauff* v. *Utah Construction & Mining Co.,* 408 F.2d 958 (10th Cir.), *cert. denied,* 396 U.S. 831 (1969); *Levin* v. *Great Western Sugar Co.,* 406 F.2d 1112 (3d Cir.), *cert. denied,* 396 U.S. 848 (1969), in the same manner as damages ordinarily are ascertained in a Rule 10b-5 action.

community. For example, Dun's Review, January, 1975, at 37, reports:

> "However one looks at it 'going private' is most often a no-win situation for public shareholders. For the buy-out price is almost always a small fraction of what the investor paid for the stock. The price, moreover is determined by a consultant hired by the buyers. The investors have a choice of taking what is offered or holding a stock that is no longer readily marketable. And the insiders have formidable legal devices available to fight investors who refuse the company's offer.
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> * * * * *
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> "Not only are the offering prices in buy-outs far below what they paid, investors claim, they often do not reflect the current financial strength of the company any more than the market price does." *Id.* at 38.

The Wall Street Journal, October 18, 1974, at 1, concurs, stating:

> "[a] move to go private ordinarily creates a conflict of interest . . . [as] controlling shareholders who directly or indirectly finance the move often are buying back their interests at only a fraction of the price at which they originally were sold to the public. . . ."

And Barron's, March 4, 1974, at 3, 13, warns:

> "Generally, it is the low price of the stock, rather than declining earnings which sends firms private. . . . Admittedly, there are times when it appears that stockholders have been had. Indeed, figures indicate that the ones benefiting most from buying back the stock are the people who sold it to the public in the first place."

In conclusion, Business Week, November 2, 1974, at 114, editorializes:

> "[T]here is a distinctly bad smell about a deal that produces a substantial loss for the majority of the shareholders and a fat profit for a tiny minority."

My purpose in referring to these current appraisals of the short-form merger device by those who have observed it in action is not to impugn the motives of the defendants in this case but to emphasize that the problem created by misuse of the short-form merger is not merely one of regulating "transactions which constitute no more than internal corporate mismanagement," *Superintendent of Insurance* v. *Bankers Life & Cas. Co., supra,* 404 U.S. at 12, but one of protecting the public investor against manipulative devices used to deceive him, and the securities market from devices serving to discredit it, which together form the primary functions of the anti-fraud and anti-manipulation provisions of Rule 10b-5. The short-form merger, when used to squeeze out small public investors by forcing them to relinquish their corporate investments at low prices for no purpose other than to benefit the insiders, can accurately be characterized as a "manipulative or deceptive device or contrivance," *id.* at 10, which interferes with the interests of the public shareholders in the most fundamental of ways, by depriving the investor of his very interest in his corporate investment. It also undercuts the broader purpose of "preserving the integrity of the securities markets," *id.* at 12, for a clearer instance of potential abuse of the market processes cannot be found. Commenting on the use of the short-form merger, SEC Commissioner Sommer has stated:

> "What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the

> whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to . . . the securities markets than he already is." ([1974-75] Fed. Sec. L. Rep. ¶ 80,010 at 84,695)

To immunize the short-form merger from the coverage of Rule 10b-5 merely because state law has authorized the device to be used for the purpose of squeezing out the public shareholders without giving them prior notice or an opportunity to obtain injunctive relief would be to ignore the central protective purposes underlying federal securities legislation and to countenance an anomalous result. Those who are most exposed and most vulnerable—the small outside public shareholders who are not privy to the inner workings of the corporate enterprise and who are forced to accept a unilaterally imposed result—would be the least protected. If they are to enjoy the protection intended to be furnished by 10b-5, that rule must not be interpreted in a technical or niggardly fashion.

When we were first called upon more than a decade ago to decide whether certain types of fraudulent corporate practices or devices fell within the proscriptions of Rule 10b-5, our initial tendency was to adhere rather closely to the elements of common law fraud (misrepresentation, reliance, scienter) in interpreting Rule 10b-5. See, e.g., *O'Neill* v. *Maytag*, 339 F.2d 764, 768 (2d Cir. 1964). Moreover we considered it essential that the fraud, to be actionable under the rule, must be intrinsic to the securities transaction itself. See, e.g., *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970), *aff'g*, 300 F. Supp. 1083 (S.D.N.Y.), *rev'd*, 404 U.S. 6 (1971). Beginning in *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393 (2d Cir. 1967), and in *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395

U.S. 906 (1969), however, we recognized that the ambit of the term "fraud" as used in 10b-5 must be widened if Congress' objective—protection of the public investor—was to be achieved. Furthermore, since only section (2) of 10b-5 deals with misrepresentation and non-disclosure, a broader definition of fraud would give effect to the prohibitions of sections (1) (employment of "any device, scheme or artifice") and (3) (engaging in "any act, practice or course of business which operates . . . as a fraud"), which disclose a broad intent to prohibit other forms of fraud. Accordingly in *Schoenbaum* we broke new ground to the extent of holding that where there was improper self-dealing and abuse of fiduciary responsibility by majority shareholders, disclosure of material facts to interested insiders would not preclude public stockholders, who were not privy to the scheme, from holding the controlling wrongdoers liable under 10b-5 for treating the public investors unfairly, even though the technical niceties of common law fraud had not been met. See Folk, *Corporation Law Developments*, 56 Va. L. Rev. 755, 806-07 (1970).

The recognition that "fraud" as that term is used in § 10(b) must be interpreted broadly was given further impetus by the Supreme Court's decision in *Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra*, where, in holding that fraud forming the basis of a 10b-5 suit need not be intrinsic to the securities transaction itself, the unanimous Court stated that "Section 10(b) must be read flexibly, not technically or restrictively," 404 U.S. at 12. In line with this philosophy we, in *Drachman* v. *Harvey*, 453 F.2d 722 (2d Cir. 1972) (en banc), reconfirmed the stand taken in *Schoenbaum* and, in a suit by public investors, held corporate directors liable under 10b-5 for their conduct in calling back their corporation's convertible debentures at an excessive price

in order to prevent conversion into common stock, which would have weakened the opportunity of a third party, with whom the directors were in conspiracy, to obtain control of the company. Judge Smith's dissent, later accepted by the court sitting en banc, did not place reliance upon evidence of misrepresentation or non-disclosure, but instead emphasized "that here the directors of Harvey, influenced by a conflict of interest and acting to support Martin's controlling interest," caused "the corporation [to] sustain . . . damage. . . ." This was considered sufficient to allege a Rule 10b-5 violation under the "broad and liberal reading" required by the rule. *Id.* at 735. More recently, in *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), in upholding 10b-5 liability we again de-emphasized the importance of alleged misrepresentations as "only one aspect" or "a part" of the illegal scheme that had at its core "market manipulation" and, as here, "a merger on preferential terms. . . ."

Defendants place heavy reliance upon *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1972), as representing a departure from our steady trend toward an expansive view of the reach of the federal security laws. However, to the extent that *Popkin* is at all relevant to the short-form merger context, it impliedly supports the application of the *Schoenbaum-Drachman* rule to this case.[3] In *Popkin*, unlike the present case, *prior* stockholder approval of the proposed merger was required. Full *advance* disclosure of the relevant facts regarding the merger ex-

[3] For support of this proposition in the literature, see Comment, *Schlick* v. *Penn-Dixie Cement Corp.: Fraudulent Mismanagement Independent of Misrepresentation or Nondisclosure Violates Rule 10b-5*, 63 Calif. L. Rev. 563, 570 (1975); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Management Cases*, 86 Harv. L. Rev. 1007, 1044 (1973); 47 N.Y.U.L. Rev. 1229, 1230 (1972).

change ratios to the minority stockholders was effective protection because it gave them the opportunity, as Judge Feinberg noted, to seek state court injunctive relief which was purportedly available under Delaware law. *Id.* at 720. Here, in contrast, disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out. Indeed, it is well recognized that the state post-merger appraisal procedure does not provide an alternative remedy comparable to federal relief.[4]

[4] Under state law the only recourse available to the aggrieved shareholders is to initiate an appraisal proceeding, thereby hoping to be awarded the full value of their lost shares. In light of a variety of factors common to state appraisal laws, it is generally agreed that they provide an unrealistic remedy. See generally, Brudney, *A Note on "Going Private,"* 61 Va. L. Rev. 1019, 1023-25 (1975); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Take Overs*, 88 Harv. L. Rev. 297, 304-07 (1974); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 Calif. L. Rev. 1, 85 (1969); Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 Yale L.J. 223 (1962).

The Delaware statute is typical. The public shareholders are afforded no right to equitable relief under the statute and therefore are totally dependent upon the valuation figure settled upon by the appraiser. *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78 (1962). Yet in determining the value of the "frozen out" shares, the appraiser may not award the public shareholders any gain resulting from the merger itself or the expectation thereof. Under the terms of the statute, any payment must be "exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation." Del. Code Ann. tit. 8, § 262(b). This measuring criterion has been interpreted very stringently. For example, an appraiser may not award "an aliquot share in the value of the assets of the merged corporation." *Application of Delaware Racing Assoc.*, 213 A.2d 203, 209 (1965). The appraiser's focus must be entirely retrospective: "The determination must be based upon historical earnings rather than on the basis of prospective earnings." *Francis du Pont* v. *Universal City Studios*, 312 A.2d 344, 348 (Ch. 1973). In short, the controlling shareholders have every incentive to "freeze out" the outsiders since, even if the appraisal procedure functions perfectly, by the terms of the statute the insiders alone capture all of the prospective gains associated with the merger.

Only through liberal interpretation of 10b-5 will the public investor gain the redress intended to be made available to him.

Our conclusion that where there has been self-dealing on the part of corporate insiders proof of misrepresenta-

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In addition, procedurally the Delaware appraisal route is far inferior to a federal cause of action in terms of protection for the minority shareholders. For example, unlike a federal class action Delaware explicitly bars those who actually initiate an appraisal from receiving compensation from non-active members of the class of displaced shareholders, even if the latter have expressed their disagreement with the merger terms and have asked to be included in the final recovery. *Raynor* v. *LTV Aerospace Co.,* 317 A.2d 43, 46 (Ch. 1974); *Levin* v. *Midland-Ross Co.,* 194 A.2d 853, 854 (Ch. 1963). The Delaware courts acknowledge that this inevitably creates a free-rider problem, see 317 A.2d at 46, which in turn insures that only a minority shareholder with a large bloc of shares will find it beneficial to seek an appraisal in the first instance. As Dun's Review, January 1975, at 64, notes: The proceeding takes years . . . and the investors do not even collect dividends while the appraisal is in the courts. Unless a shareholder has at least 20,000 shares, most attorneys believe it rarely pays off financially. . . ." Furthermore the statute expressly excludes the costs of attorneys or expert fees from the appraisal recovery. Tit. 8, § 262(h).

Finally, the extent of discovery rights available to displaced investors remains unclear. The statute provides that the appraiser "may" examine any books and records of the corporation in question, § 262(e), but says nothing about the minority shareholders other than to insure them "a reasonable opportunity . . . to submit to him pertinent evidence on the value of the shares," § 262(e). In the past, when "frozen out" shareholders have attempted "to complicate the issue raised" by demanding "proceedings of an adversary nature," they have been repudiated. *Lichtman* v. *Recognition Equipment Inc.,* 295 A.2d 771, 772 (Ch. 1972) (claimant cannot introduce evidence of the value of stock options lost due to the merger). And while the outside shareholders therefore remain heavily dependent upon the corporation for information, Delaware law does not require disclosure of such information to shareholders even after the fact except for notice of the completed merger and a statement of the buy-out price. Tit. 8, § 253(d). As one commentator notes, "[t]he crucial valuation evidence—estimates of future earnings or of salable value of assets —is available to management but rarely to outsiders. Hence, these evidentiary problems which beset an outsider seeking appraisal or challenging for unfairness a merger which was timed by insiders make it a rare case in which he will succeed in establishing a value higher than was offered in the merger, in view of the leeway which courts allow to management's judgment." Brudney, *supra,* at 1024 n.21.

tion or non-disclosure is not a *sine qua non* to the establishment of 10b-5 liability is shared by other Circuits. In *Pappas* v. *Moss,* 393 F.2d 865, 869 (3d Cir. 1968), Judge Seitz held "that where, as here, a board of directors is alleged to have caused their corporation to sell its stock to them and others at a fraudulently low price, a violation of Rule 10b-5 is asserted." The only deception found in the case, two misstatements in the shareholder resolution authorizing the sale, was of no practical consequence to the wrongdoing since shareholder ratification was unnecessary under state law and, in any event, was sought only after the sale was consummated. *Id.* at 867, 869. Similarly, the Fifth Circuit has repeatedly held corporate insiders liable under Rule 10b-5 in the absence of misrepresentation. For example, in *Rekant* v. *Desser,* 425 F.2d 872, 882 (5th Cir. 1970) (Wisdom, *J.*), the court wrote:

> "We conclude, therefore, that when officers and directors have defrauded a corporation by causing it to issue securities for grossly inadequate consideration to themselves or others in league with them or the one controlling them, the corporation has a federal cause of action under § 10(b). . . . The essence of the transaction is not significantly different from fraudulent misrepresentation perpetrated by one individual or another."

Similarly, in *Shell* v. *Hensley,* 430 F.2d 819, 826-27 (5th Cir. 1970) (Ainsworth, *J.*), citing *Schoenbaum,* the court held directors liable for scheming to sell control to another corporation. In response to the argument that there had been no deception of the corporation warranting 10b-5 liability, since the controlling directors had all the relevant information, the court responded that to so construe 10b-5 would be to permit "the basest sort of chicanery" and re-

move the "protection of the section and the rule merely because of the ease with which defendants victimized [the corporation]." See also *Bryan* v. *Brock & Blevins Co.*, 490 F.2d 563, 571 (5th Cir.), *cert. denied,* 419 U.S. 844 (1974); *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515, 527 (8th Cir. 1973) (Rule 10b-5 liability found even though "[t]he essence of the plaintiffs' complaint . . . is that the defendants violated § 10(b) and Rule 10b-5 by engaging in self-dealing. . . . Here, as in *Sup't of Insurance,* the defendants' self-dealing was a violation of a fiduciary obligation to minority shareholders. . . .").

Defendants' efforts to reconcile these decisions by searching for some misrepresentation or non-disclosure ignores the court's plain language in each case and exalts form over substance. Such misrepresentations as may be found generally related to technical, trivial matters, having little or no relevance to the manipulative conduct giving rise to 10b-5 liability. Furthermore, in some of the cases the courts, in imposing § 10(b) liability, were quite explicit in acknowledging the absence of misrepresentation or openly minimizing its import to the illegal conduct under challenge.

Thus our decision today is not only consistent with the trend of our own case law on the subject of 10b-5 liability but with the line of authority developing in other Circuits. In holding that a short-form merger which lacks any legitimate corporate purpose may violate 10b-5 we of course do not foreclose use of the device for legitimate corporate purposes. Such a merger, for instance, might lawfully provide an acceptable method of enabling a corporation to achieve substantial savings in operating expenses or to dispose of an unprofitable business at a favorable price. However, where a short-form merger involving use of a dummy corporation appears to be used for no purpose other than to squeeze out minority public shareholders, as is alleged in this case, the burden is upon the corporate in-

siders to demonstrate the existence of a legitimate compelling corporate purpose.

MOORE, *Circuit Judge* (Dissenting):

I most strongly dissent from the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven States.[1]

By their opinion, the majority has found a fraudulent scheme, and hence a violation of Rule 10b-5 where none exists. They have established an irrebutable presumption that use of the short-form merger law amounts to a fraud

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[1] The following States have short-form merger statutes (the percentage of the subsidiary's stock which must be owned by the parent appears in parenthesis after each State):

Nebraska (80%)
• • •
Arkansas (90%)
Colorado (90%)
Connecticut (90%)
Delaware (90%)
Florida (90%)
Georgia (90%)
Hawaii (90%)
Iowa (90%)
Kansas (90%)
Kentucky (90%)
Louisiana (90%)
Maine (90%)
Maryland (90%)
Massachusetts (90%)
Michigan (90%)
Nevada (90%)
New Jersey (90%)
Ohio (90%)
Oregon (90%)
Pennsylvania (90%)
Rhode Island (90%)
Tennessee (90%)
Texas (90%)
Utah (90%)
Virginia (90%)
West Virginia (90%)
Wisconsin (90%)
• • •
Indiana (95%)
Mississippi (95%)
Montana (95%)
New Mexico (95%)
New York (95%)
North Dakota (95%)
South Carolina (95%)
Vermont (95%)
Washington (95%)
• • •
Illinois (99%)

per se. They have added a clause to the Delaware statute —not placed there by the State's legislature—that a short-form merger must have a "justifiable corporate purpose". They have manufactured evil intent and attributed it to individuals who were merely following the lawful edicts of Delaware, to the point of characterizing as "full of cunning and guile", and "so sophisticated as almost to defy belief", corporate actions of the utmost simplicity and patent reasonableness in today's economy and securities market.

My agreement with the majority starts and stops on the first page of its opinion. The case is "important, [and] interesting"; it is not "complicated". Although legal issues are frequently clothed in dark and light shades of gray, the case at bar is a study in the stark contrast of black and white. The majority's conjury in holding that this case presents a violation of Section 10b of the Securities and Exchange Act and Rule 10b-5 promulgated thereunder[2] is totally without factual anchor, and I cannot refrain at the outset from objecting to the fraility of their factual foundation, which is truly of the character of bricks without straw and an omission that warrants immediate correction.

I. The Facts

The facts are not in dispute, and should be stated for the record in their particulars.

The sovereign state of Delaware in its legislative wisdom enacted a statute, which gives to corporations chartered under its laws, the privilege of merging parent and subsidiary under strictly limited circumstances, namely, owner-

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[2] Section 10b prohibits only those manipulative or deceptive devices "in contravention of such rules and regulations as the Commission may prescribe". A condition precedent to a violation of Section 10b is therefore the violation of the appropriate SEC rule, namely, 10b-5. *See* n. 4, *infra.*

ship by the parent of at least 90% (here approximately 95%) of the stock of a subsidiary. Delaware General Corporation Law (DCL) § 253. The statute provides for the payment of cash to the minority stockholders or, in the event that any such stockholder is dissatisfied with the cash offer, he may seek an appraisal in the Delaware Court of Chancery to establish the stock's value. DCL §§ 253(d), 262. In any such proceeding the stockholder would be able to adduce whatever proof he might believe to be supportive of his theory of true value.

The statute, referred to as the "short-form" merger proceeding, contains no provision for advance notice of the merger to be given to the minority (10% or less); only approval by the parent's directors and stockholders is required. Notice of the merger, however, has to be given within 10 days of its effective date, and within 50 days thereafter (following an initial demand within 20 days on the surviving corporation) appraisal, if desired, must be sought. DCL § 253(d).

Prior to the merger at issue, some 95% of the stock of Kirby Lumber Corporation (Kirby) was owned by Santa Fe Natural Resources, Inc. (Resources) which in turn is wholly-owned by Santa Fe Industries, Inc. (Santa Fe).

Plaintiffs are in the 5% (approximately) minority group of Kirby.

To take advantage of § 253 of the Delaware Corporation Law another Delaware corporation, Forest Products, Inc. (FPI) was organized which acquired from Resources its Kirby stock (95%) and on July 31, 1974 Kirby and FPI were merged.

Some time prior to the merger (February 19, 1974) defendants[3] had obtained from Appraisal Associates a writ-

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[3] Defendants, unless otherwise specified, will refer to the Santa Fe defendants, excluding Morgan Stanley & Co.

ten appraisal of the land (exclusive of minerals), timber, buildings and machinery of Kirby as having a market value of $320,000,000. Such an appraisal of physical assets mathematically would have amounted to a book value of the outstanding shares of Kirby of $722.

Subsequently, defendants, seeking a fair market value appraisal of the Kirby stock as of June 24, 1974, obtained from Morgan Stanley & Co. a stock valuation of $125 per share. This figure was given with knowledge of Appraisal Associates' valuation of Kirby's physical assets of $320,000,000.

After the merger, as provided by Delaware law, DCL § 253(b), namely, "within 10 days after the effective date of the merger", notice of the merger was given to the minority stockholders that they had a right to receive $150 per share in cash or to seek an appraisal of the value of their shares as provided by Delaware law. DCL § 253(d).

Accompanying the notice was a statement (some 57 pages of the Appendix) which, in addition to setting forth extensive financial data, included: (1) the Morgan Stanley stock value based largely upon the price ranges for the Kirby stock freely traded on the market; (2) the Appraisal Associates' appraisal of physical assets of $320,000,000; and (3) an appraisal by Riggs and Associates of Kirby's oil, gas and mineral property interests.

On August 21, 1974 plaintiffs elected to pursue the Delaware law remedy of demanding an appraisal. Thereafter, they changed their minds and on September 9, 1974 withdrew this demand. The next day they filed their complaint in the federal court seeking to bring their claim within Section 10b of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5, 17 C.F.R. 240, 10b-5. Their original complaint was based primarily on the claim that defendants sought to acquire the minority's stock at a "grossly undervalued price" which constituted in plaintiffs' opinion a "manipulative and deceptive device"

amounting to a violation of Rule 10b-5 and "a breach of fiduciary obligation owed to Kirby and its minority stockholders." (Compl. par. 9) An amended complaint added a claim of diversity jurisdiction over the defendants.

At this point it is essential to underscore what was *not* involved in the merger. There was no failure to comply with state law. There was no failure to disclose by the defendants. On the contrary, all of plaintiffs' assertions of stock value derived from the report circulated by the defendants to the minority shareholders. Similarly, there was no misrepresentation of fact or law made to the minority.

II. Federal Law

The purpose of § 10b of the Act, and Rule 10b-5 promulgated thereunder, is the elimination of fraudulent practices in the securities industry. These are anti-fraud provisions, and the existence of fraud is the key to their application.[4]

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[4] Rule 10b-5, which gives exclusive effect to Section 10b, is entitled "Employment of manipulative and deceptive devices", and declares it to be unlawful for any person,

> "(a) To employ any *device, scheme, or artifice to defraud,*
>
> (b) To *make any untrue statement* of a material fact or to *omit to state a material fact* necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any *act, practice, or course of business which operates or would operate as a fraud or deceit* upon any person,
>
> in connection with the purchase or sale of any security." (emphasis added)

Subsection (b) is inapplicable here because no claim is made that there were any untrue statements or omissions in the vast amount of information given to the minority stockholders. Plaintiffs' claims must, therefore, rest upon defendants' use of the Delaware statute as a "device * * * to defraud" (subsection (a)) or an "act * * * which [operated] as a fraud or deceit * * *."

It states the obvious to say that the essence of fraud is deliberate deception or concealment which is calculated to deprive the victim of some right or to obtain, by deceptive means, an impermissible advantage over him.[5] It was to eliminate such deception and concealment that the federal securities laws imposed a duty to disclose on those with inside information. Similarly, it has been to eliminate deception and concealment, *i.e.*, to eliminate *fraud*, that the courts have stringently enforced this duty, imposing liability whenever a defendant fails to disclose his actions, his position, or his knowledge.

The majority cites numerous cases en route to its holding that failure to disclose is no longer a prerequisite for liability under Rule 10b-5—that, in fact, liability under the anti-fraud provisions of 10b-5 will attach in the *complete absence* of any deception or misrepresentation, in short, in the complete absence of fraud altogether. This is an untenable hypothesis, and one which is totally disproved by even a cursory review of the decisions in the area. I propose to review the leading cases in order to dispel at once any rumors that 10b-5 no longer concerns itself with fraud, but instead extends to every corporate transaction viewed with displeasure by the courts.

In 1964 in *Ruckle* v. *Roto Amer. Corp.*, 339 F.2d 24 (2d Cir. 1964), the directors of the corporation approved the issuance of stock to its president for an inadequate consideration. It was alleged that information material to the exercise of informed judgment had been withheld from the directors—a clear instance of fraud.

The same year this Court decided *O'Neill* v. *Maytag*, 339 F.2d 764 (2d Cir. 1964), in which we said: "There can be no serious claim of deceit, withheld information or mis-

[5] *See, e.g., Black's Law Dictionary* (4th Ed. 1951) at 788-789; *Ballentine's Law Dictionary* (3d Ed. 1969) at 496-497.

statement of material fact in this case"; the opinion went on to say that, where a complaint alleges a breach of the general fiduciary duty existing among corporate officers, directors and shareholders, "no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to deception." 339 F.2d at 767, 768

SEC v. *Capital Gains Research Bureau*, 375 U.S. 180 (1964), is cited by the majority but in fact is more supportive of the dissent. *Capital Gains*, it should be noted at the outset, was not a 10b-5 case; it involved the unique duties and responsibility of investment advisors to their clients. The entire case was concerned with non-disclosure—specifically, with the failure of the defendant-investment advisor to apprise his clients of his self-interest in their transactions. The defendant's practice had been to buy a stock shortly before recommending it in a newsletter to his clients, and thereafter to sell it (usually within two weeks of the dissemination of the newsletter). The Supreme Court interpreted his legal and equitable duty *not* as a duty to refrain from trading himself (an act not prohibited by state law) but as a duty to disclose whatever interest he in fact had. It was not the existence of self-interest or of the defendant's action in furtherance thereof which went afoul of federal securities law; it was his *concealment* of those facts.

Three years later this Court decided *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967). Implicitly acknowledging the validity of short-form mergers,[6] the Court struck down a fraudulent sale

[6] "Thus, once the conditions for a short-form merger had been achieved, appellant's rights in his stock were frozen. *He had and still has only the options of exchanging his stock* for $3.29 a share, pursuant to appellee's offer, *or pursuing his right of appraisal*, which would also result in cash from appellee." 374 F.2d at 634. (emphasis supplied)

of certain stock shares at an inflated price on the ground that the scheme presented "a classic case of deception". 374 F.2d at 635. Ruling on the applicability of the federal securities laws to corporate mergers, the Court held:

> "What must be shown is that there was *deception* which misled the Class A Stockholders. . . ." 374 F.2d at 635. (emphasis supplied)

In 1968 came *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968), a case much relied upon by appellants, heard by an *en banc* Court. This case in many respects was a counterpart of *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968) (*en banc*). In *Schoenbaum*, Aquitaine, which controlled Banff Oil, had knowledge of an important oil discovery by Banff. Without disclosing this fact, Aquitaine caused Banff to issue to it 500,000 shares of Banff at $1.35 a share. After the public announcement of the discovery, Banff stock sold as high as $18 a share. There was more than sufficient indicia of fraudulent non-disclosure to justify denial of a summary judgment motion.

In 1971 the Supreme Court decided *Supt. of Insurance* v. *Bankers Life and Cas. Co.*, 404 U.S. 6 (1971), on appeal from this Circuit. The fraud there was most flagrant. One Begole and a group agreed to buy for themselves all of Manhattan Casualty Company's stock from Bankers Life for $5,000,000 and conspired with others to pay for the stock, not with their own funds but, once they had obtained the stock, out of Manhattan's own assets. A more fraudulent scheme would be difficult to imagine.

In 1972 came both *Drachman* v. *Harvey*, 453 F.2d 722 (2d Cir. 1972) (*en banc*) and *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1972). The Court in *Drachman* found that as the result of a conspiracy, whereby the Harveys had sold their controlling interest in Harvey Aluminum to Martin

Marietta at handsome premium for themselves and they had caused Harvey Aluminum to redeem its convertible bonds to preserve Martin-Marietta's stock control of Harvery Aluminum, there was fraud within the scope of § 10-b and Rule 10b-5.

Popkin presented a somewhat different situation. It was largely to enjoin a merger on the ground that the exchange ratio of the respective stocks was unfair. This Court reviewed the many cases in this field, noting that "Emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases", 464 F.2d at 719, and concluding that "when there has been such disclosure of a merger's terms, it seems unwise to invoke federal injunctive power, particularly since doing so might well encourage resort to the federal courts by any shareholder dissatisfied with a corporate merger". *Id.* at 720. But, even assuming the federal courts are anxious to reach out for this sort of business, to do so at the cost of nullifying the corporate laws of many states respecting mergers of comparatively fractional amounts of outstanding stock should cause some restraint in enacting such judicial legislation.

Other circuits have found conspiracy and deception as basic in bringing cases within the statute and Rule. *See* *Dasho* v. *Susquehanna Corporation*, 380 F.2d 262 (7th Cir., 1967) and *Shell* v. *Hensley*, 430 F.2d 819 (5th Cir. 1970). And of particular interest because it was decided in a federal court in Delaware is *Voege* v. *American Sumatra Tobacco Corporation*, 241 F.Supp. 369 (U.S.D.C., Delaware, 1965). It, too, was a "merger" case. On the merger, $17 a share was offered; the plaintiff refused the offer and demanded an appraisal but, in so doing, did not know that as part of the merger it was planned to sell off a part of *Sumatra's* physical assets (land) which would alone bring in more than $17 a share. The Court, noting that the de-

fendants—for purposes of their motion to dismiss—conceded that their misleading statements amounted to a scheme to defraud under Rule 10b-5, held that the plaintiff could be regarded as a "seller" within the meaning of the Rule. Appraisal was held to be an insufficient remedy because of plaintiff's ignorance of the fraud at the time she demanded the appraisal. 241 F. Supp. at 375.

The District Court in this Circuit recently considered the permissibility of corporate mergers for purposes of enforcing federal securities law. In *Levine* v. *Biddle Sawyer,* 383 F.Supp. 618 (SDNY 1974), which involved a short-form merger, the Court denied defendant's motion for judgment on the pleadings on the ground that the facts presented a "scheme of deceit and concealment". 383 F. Supp. at 622.

Still more recently, in *Kaufman* v. *Lawrence,* 386 F. Supp. 12 (SDNY 1974), *aff'd per curiam,* Slip Op. at 2707 (4/3/75), the District Court refused to grant a preliminary injunction to halt a long-form corporate merger on the grounds that material omission had not been shown, and that the case was not one involving "any hidden or secret action by an outside group to take over control of the company". 386 F. Supp. at 17. The Court concluded pertinently:

> While Sections 10(b) and 14(e) must be read flexibly, and not technically or restrictively, * * * there is nothing invalid *per se* in a corporate effort to free itself from federal regulations, provided the means and the methods used to effectuate that objective are allowable under the law. Nor has the federal securities law placed profit-making or shrewd business tactics designed to benefit insiders, without more, beyond the pale. Those laws in respect of their design and interpretive reach, as I understand them, include the provisions relied on here, and are satisfied if a full and

> fair disclosure is made, so that the decision of the holders of WRG stock to accept or refuse the exchange offer can be said to have been freely based upon adequate information.
>
> A public company going "private" may indeed raise serious questions concerning protection of the public interest. There is, however, no foundation on the record before me from which the ramifications of that interest within the reach of the federal securities laws might conceivably be explored. . . . *Ibid.* (citations omitted)

Non-disclosure for purposes of deliberate concealment or misrepresentation is the essence of fraud, and synonymous with liability under Section 10b and Rule 10b-5. Against this setting the facts at bar are startling for the picture of unquestionable non-liability under Rule 10b-5 which they present. To reiterate, the defendants—pursuant to a duly enacted state law—effected a merger of a parent corporation and its 95%-owned subsidiary. This transaction is expressly sanctioned by statute, and all statutory requirements were complied with. Complete disclosure regarding valuation of shares was made. There was no attempt to hide the merger, or to misrepresent the minority's right to object and demand appraisal. On the contrary, the minority were expressly informed of their right to do so.

To conclude that this series of events presents a scenario of fraud is a patent distortion of that term. This case presents no claim of fraud at all, and appending the label of "fraud" to plaintiffs' complaint or the majority's opinion does not change the fact one iota. The facts adduced here are wholly unrelated to any cause of action under Section 10 and Rule 10b-5, and legal legerdemain cannot render them otherwise.

II. State Law

The majority concedes that when it speaks of fraud, it does not mean "fraud" at all, but rather a breach of fiduciary duty. Majority opinion at 9, 16. Under the law, breach of fiduciary duty and commission of fraud are wholly different from one another, as was recognized by this Court in *O'Neill* v. *Maytag, supra,* at 339 F.2d 767:

> While the essence of these [fiduciary] duties in some circumstances is honest disclosure, the allegations in the instant case are typical of situations in which deception may be immaterial to a breach of duties imposed under common law principles.

The majority's insistence on extending federal securities anti-fraud provisions beyond the bounds of fraud and into the realms of fiduciary duty is disturbing enough. Accompanied, as it is, by their erroneous finding of a breach of such duty, and by the astonishing and impermissible establishment of a federal common law of corporations—as ill-founded as it is improper—disconcertion must give way to alarm.

There is no question that it is within the proper power of the State to enact statutes regulating corporation mergers. Corporations are creatures of the State. They are created under State law; they are empowered by State statute; and they are regulated by the legislative mandates of the State which has sanctioned their existence. Every State in the Union has comprehensive general business or corporation codes which attest to the exercise of the States' proper responsibilities over the formation of corporate entities and the regulation of corporate activities.

Exercising its unquestionable right to determine the statutory rights and duties of parent and subsidiary corporations chartered under its laws, Delaware has permitted

subsidiaries to dispense with what would be the mere formality of a shareholder vote on merger in those circumstances in which the parent already owns an overwhelming majority of the subsidiary's shares. Delaware law does *not* require that the merger be pursuant to any corporate purpose more limited than the general corporate purposes contained in the corporate charter, which set the boundaries beyond which the corporation will be said to act *ultra vires*. The short-form merger statute is not a procedure designed to effect certain business outcomes; it is the articulation of certain substantive rights which are given to majority and minority shareholders in the State of Delaware[7]—respecting the parent corporation, a right to expedite a merger which is already assured by the parent's overwhelming majority ownership of the subsidiary; respecting the minority, a protective "right to object and demand appraisal". *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 893, 896 (Del. 1959).

The majority misses the point entirely when it comments, as the justification for sidestepping Delaware law, that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law" (citing *Vine* v. *Beneficial Finance Co. supra*). Majority opinion at 6. "Cause of action" means "judicial remedy," not statutory right or compliance with state law, and the *Vine* Court stated the rule correctly when it held that

> [W]e do not regard the existence of a *state remedy* as negating the federal right. *Vine* v. *Beneficial Finance Co.*, 374 F.2d at 635-6 (emphasis supplied)

The substantive rights created by § 253 have been explicitly upheld as a valid regulation of Delaware corpora-

[7] This was the Court's express holding in *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. 1959).

tions. The Delaware courts have also explicitly rejected the notion that the exercise of rights accorded by § 253 is itself a breach of duty or a perpetration of fraud. Focusing on the plaintiff's charges of fraud in connection with the statutory merger under § 253, the Supreme Court of Delaware ruled, in the leading case on the subject:

> The complaint, of course, contains allegations of oppressive treatment of the minority by the parent corporation, and a prayer that the merger be set aside. But it is plain that the real relief sought is the recovery of the monetary value of plaintiff's shares—relief for which the statutory appraisal provisions provided an adequate remedy. The Vice Chancellor held that in the circumstances of this case that remedy was exclusive. His analysis . . . was thorough and well-considered, and we agree with it. . . .
>
> [It is argued that] the appraisal remedy under our statutes should not be held to be exclusive.
>
> The answer to this is that the exception above quoted refers generally to all mergers, and is nothing but a reaffirmation of the ever-present power of equity to deal with illegality or fraud. But *it has no bearing here. No illegality or overreaching is shown. The dispute reduces to nothing but a difference of opinion as to value.* Indeed it is difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle the minority to set aside the merger. . . . *This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of a breach of trust against the directors of the* [*merged subsidiary*]. . . . *Stauffer* v. *Standard Brands, Inc.,* 187 A.2d 78, 80 (Del. 1962).[8] (emphasis supplied)

[8] *See also, Carl Marks & Co.* v. *Universal City Studios, Inc.,* 233 A.2d 63 (Del. 1967).

This holding accords with the Delaware common law respecting the equitable duty of fiduciaries which, like the statutory law of corporations, lies within the province of the States. Under Delaware law, it is not a *per se* breach of the duty owed the *cestui* for the fiduciary to deal in trust property; in other words, self-dealing is not, by definition, a prohibited activity. Where, for example, the fiduciary has certain already existing rights to acquire the property of the *cestui,* and where these rights are exercised openly and without deception, no violation of the trust results and a court of equity will not enjoin the acquisition.[9] On the contrary, where legal rights attend the parties to a fiduciary relationship, a court of equity will enforce those rights and will not permit a plaintiff to eschew legal rights and duties under the guise of invoking the court's equitable jurisdiction.[10] This is, of course, only an expression of the historic maxim and controlling principle that "Equity follows the law".[11]

To place the plaintiffs' allegations in this case into sharp focus, I would turn for a moment to plaintiffs' complaint. Emerging from plaintiffs' extravagant characterization of defendants' conduct as an "unconscionable self-deal" (3) a "FLAGRANT SELF-DEAL WHICH OPERATED AS A FRAUDULENT DEVICE", "a fraudulent overreaching" (16), an "unconscionable taking without compensation" (19) and a

[9] *See, e.g., In re Thomas,* 311 A.2d 112, 114 (Del. 1973); *Equitable Trust* v. *Gallagher,* 102 A.2d 538, 545 (Del. 1954).

[10] *See, In re Markel,* 254 A.2d 236 (Del. 1969); *Richard Paul, Inc.* v. *Union Improvement Co.,* 91 A.2d 49 (Del. 1952); *Wise* v. *Delaware Steeplechase & Race Ass'n.,* 45 A.2d 547 (Del. 1945).

[11] *See, generally,* 27 Am .Jur. 2d Equity §§ 118, 124; 30 C.J.S. Equity § 103; 13 Atlantic Rptr. Digest, Equity § 62; 30 A.L.R.2d 925; 9 A.L.R.2d 295.

"secret squeeze-out" (31),[12] plaintiffs' claims stand out in bold relief: (1) the merger was "Without any notice or disclosure whatsoever to the minority stockholders of Kirby" (Br. p. 4) and (2) the price of $150 offered was grossly below the $772 value of each share based on plaintiffs' theory of dividing the physical assets proportionately among the stockholders. It is on these grounds that the plaintiffs seek equitable intervention by the courts to effect a rescission of the merger.

As must be plain by this point, neither of plaintiffs' two claims warrants such relief. With respect to prior notice, plaintiffs were entitled to none by law—a not unreasonable provision in light of the fact that, under § 253, the 10% minority shareholder is entitled to fair value of his shares, and *not* to any opportunity to thwart the will of the overwhelming majority.[13] The parent corporation breached no fiduciary duty by exercising its statutory option to acquire the subsidiary without notice. The minority shareholders had no right to prevent such acquisition, or to challenge its legality on statutory grounds. Moreover, the minority shareholders had no right to demand from an equity court an affirmative right to notice in abrogation of the legal rights of the parent corporation, created by statute and recognized at common law and equity by the Delaware Courts.

With respect to the alleged undervaluation of plaintiffs' shares, Delaware law gives the dissenting shareholder a

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[12] It should be noted that all of these taken together are insufficient *as a matter of law* to satisfy the pleading requirements of F.R.C.P. 9(b) which mandates that allegations of fraud be supported by factual particulars.

[13] *See,* Borden, "Going Private—Old Tort, New Tort, or No Tort?", 49 N.Y.U.L.R. 987 (Dec. 1974) (hereinafter "Borden") at 1031, n. 194, for an illuminating evaluation of minority shareholders' prerogative to overrule the majority's will in connection with corporate mergers.

right to object, and affords him the legal remedy of appraisal. This is held to be both adequate and exclusive under § 253;[14] equitable relief, absent fraudulent deception or concealment, is unavailable.[15] It is important to stress that the discrepancy in claimed value of the Kirby stock does not *ipso facto* bespeak fraud. Although they refer to going concern value (but without supporting proof), plaintiffs' asserted value appears to be based on the assumption that the Kirby physical assets could be liquidated at the appraisal price and the proceeds divided up amongst the stockholders. However, there is nothing in the record to indicate that Kirby had any intention to liquidate and go out of business or that plaintiffs as holders of 143 shares had any power to compel liquidation. Moreover, under Delaware law a dissenting shareholder cannot recover in appraisal proceedings the "liquidation value" of his shares (*i.e.,* a sum equal to his aliquot share in the value of corporate assets); he is entitled only to "the intrinsic value of [his] shares determined on a *going concern* basis". *Application of Delaware Racing Ass'n.,* 213 A.2d 203, 209 (Del. 1965). (emphasis supplied)

By their complaint plaintiffs have utterly failed to assert any cognizable breach of fiduciary duty; any injury entitling them to equitable relief; any fact whatsoever indicating impermissible overreaching or deception by the defendants. There has been total compliance with state law, complete disclosure of valuation data, and total availability to plaintiffs of Delaware's appraisal procedures. Significantly, all of plaintiffs' assertions of stock value derive from the report circulated by the defendants to the minority shareholders.

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[14] *Stauffer* v. *Standard Brands Inc., supra,* at 187 A.2d 80.

[15] *Ibid.*

IV. The Majority's Holding

Notwithstanding all of the above, the majority has purported to find a violation of law that warrants equitable intercession. The majority's theory is that there was a breach of fiduciary duty to the minority because the merger did not have a "justifiable corporate purpose". This purported fiduciary standard is completely untenable; further comment on it will be made *infra.* First and foremost, however, the point must be made that, in taking cognizance of plaintiffs' claim, the majority has not provided a remedy to correct a fraud; rather it has extended to those plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity.[16] Indeed, the majority appears to have ignored the Supreme Court's decision in *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1939), which put an end to federal common law and forbade the federal courts from formulating their own "better rule."[17]

[16] When it is remembered that some three-quarters of the States have statutes similar to the Delaware short-form merger law, the magnitude of the majority's holding may be readily appreciated. *See* n. 1, *supra.*

[17] The Third Circuit, specifically referring to the law governing fiduciary duty, said as much in the well-known diversity suit of *Zahn* v. *Transamerica Corp.,* 162 F.2d 36, 42 (3d Cir., 1947):

> "In our opinion . . . the law of Kentucky imposes upon the directors of a corporation or upon those who are in charge of its affairs . . . *the same fiduciary relationship* in respect to the corporation and to its stockholders *as is imposed generally by the laws of Kentucky's sister States or which was imposed by federal law prior to Erie R. Co.* v. *Tompkins.*" (citation omitted; emphasis supplied)

See, also, O'Neill v. *Maytag,* 339 F.2d 764, 767 (2d Cir. 1964), wherein we held that:

> "Between principal and agent and among corporate officers, directors and shareholders, *state law has created duties which exist independently of the sale of stock.* While the

Reaching back to *Swift* v. *Tyson,* 16 Pet. 1 (1812), the majority has obviously rejected the valid state standards of Delaware defining fiduciary duty, and the valid state laws regulating the powers of state-created corporate bodies. The majority has tossed these off as so much *obiter dicta* and independently pursued a "better rule", altering the rights of parent corporations and minority shareholders in order to suit the majority's pleasure. The majority's use of the term "fraud" is no more than a smoke-screen; there is no factual foundation presented by the plaintiffs which indicates any fraud in this case. Moreover, under Delaware law, the short-form merger statute is part and parcel of the charter of every Delaware corporation, and of the contract between every such corporation and each of its shareholders.[18] The majority thus is redrafting corporate charters and private contracts at the same time as it is putting a torch to the teachings of *Erie.* In effect the majority has decided that equity will not follow the law, it will rewrite it.

Their choice for a federal fiduciary standard respecting corporations is the best possible indication of the error of the majority's holding. "Justifiable corporate purpose", as it is used in the majority opinion, is a totally amorphous standard which, although it is nowhere defined in the majority opinion, is nevertheless so inapposite as applied to short-form mergers that it cannot withstand even superficial scrutiny.

> essence of these duties in some circumstances is honest disclosure, *the allegations in the instant case are typical of situations in which deception [under Rule 10b-5] may be immaterial to a breach of duties imposed under common law principles.*" (emphasis supplied)

That the federal courts' rules, in fact, may not necessarily be "better" is exemplified by the federal test for fiduciary duty adopted by the majority here. *See* this dissent, *infra* at pp. 1996-1999.

[18] *Vocge* v. *American Sumatra Tobacco Corp.,* 241 F. Supp. 369 (D. Del. 1965); *Greene* v. *Schenley Industries,* 281 A.2d 30, 35, 36 (Del. Ct. Ch. 1971).

The short-form merger procedure permits a corporation to retreat from the public marketplace of securities trading and assume the status of a private company. "Going private", as the process has been popularly labeled, is being more and more frequently resorted to in today's recession economy. The benefits to a corporation are varied. Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment—these are some of the advantages which may enure to a corporation "going private".[19] It is essential to underscore that *all* of the above-stated advantages accrue from the *very act of eliminating the 10% shareholders who confer public status on the corporation.* To say that such action is not a "valid business reason" (plaintiffs' complaint) or a "justifiable corporate purpose" (the majority holding) is to completely misapprehend the impact of the shift in status from publicly held corporation to private company. Benefit to the parent company is not incompatible with the notion of "justifiable corporate purpose"; it is a legitimate part of it. As one commentator has noted:

> The selfish motivation is often adverted to in connection with going private, but one wonders why that should be. Are only those corporate transactions to be favored which are not motivated by greed? Must we seek to do public good in order to avoid regulatory

[19] For an excellent discussion of the phenomenon and its impetus, *see* Borden at 1006-1018.

> sanctions? The questions answer themselves. To observe that greed is a compelling motivation is merely to observe that we live in a free-enterprise society.[20]

It should be obvious that minority shareholders are as similarly motivated as the majority owners, and that their concern is not the purported damage to the public of "going private" transactions—the likelihood of which I seriously doubt—but rather, the equally selfish desire to avoid taking a loss while "playing the market". Such a desire, I submit, is a wholly inadequate justification for according to the 10% a veto power over the will of the 90%. Even our political system does not require 100% consensus before the majority will may be implemented; in fact, such a thought would be completely inimical to the values inherent in our democratic philosophy.

It should be recognized that, in a transaction such as the short-form merger at issue here, the parent corporation does not require any practical power or control over corporate management that it did not already have as a 90% owner. To the degree that the majority condemns "self-aggrandizement" as an effort to acquire control for self-benefit, then the merger *per se* results in no increased aggrandizement at all:

> If the evil in going private is perfecting or ensuring control, it would follow that there would be no wrong when the proponents of the transaction already have an impregnable hold on control. . . .[21]

Whatever "justifiable corporate purpose" may mean, it should be obvious from the above that, as utilized by the majority, it is a completely irrational concept that bears

[20] Borden, at 1043 (footnote omitted).

[21] *Ibid.* at 1031, n. 194.

no reasonable relationship to the realities of short-form mergers in the actual business world.

I cannot believe that the majority has chosen to exceed the bounds of its jurisdiction under federal law in order to espouse so frail a concept, and I am more convinced than ever of the wisdom which the Supreme Court showed in compelling the federal judiciary to refrain from the business of rewriting state law by judicial fiat.

V. The Concurrence

Judge Mansfield in his concurring opinion falls into the same error as is so obvious in the majority opinion, namely, that "a short-form merger consummated without any legitimate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5." In short, any use of the Delaware statute is fraud *per se,* tantamount to a "device, scheme or artifice to defraud" and a course of business conduct that operates "as a fraud or deceit".

Particularly disturbing is the unfounded hypothesis that the merger was intended to take improper advantage of market conditions by the deliberate tender to plaintiffs of a grossly inadequate price for their shares. Plaintiffs themselves do not go so far by way of allegation.

Judge Mansfield in footnote 4 argues the inadequacy of an appraisal proceeding in fixing a fair market price and straightaway concludes that a federal court "would be required to determine a fair buy-out price"—the very determination which the Delaware law provides. On such a hearing the same items of proof would undoubtedly be offered: purchases and sales of Kirby stock by willing purchasers and sellers on or off public trading markets over a period of time; annual earnings per share in years good and bad; price/earnings ratios; projected earnings;

and the physical asset value, as appraised, of $320,000,000.[22] The trial would have become a battle of experts, financial, accounting and physical property appraisers, but with the judicial system of Delaware available for this purpose it would not have lacked due process. Where there are disputes between parties as to fair values the courts not infrequently become the final arbiters, but the courts of the Second Circuit should not appropriate unto themselves the exclusive right and competence to engage in such determinations.

In summary, in my opinion, both majority and concurring opinions depart widely from the Congressional purpose in enacting Section 10b, from our own decisions thereunder and from the Supreme Court's interpretation thereof—thus far.

I would affirm the District Court's dismissal of plaintiffs' complaint.

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[22] Public financial information makes available the fact that many stocks publicly traded sell at prices only a fraction of their book value, whereas others sell at prices far in excess thereof.

Appendix D—Memorandum of the Court of Appeals Denying the Petition for Rehearing En Banc.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the tenth day of March, one thousand nine hundred and seventy-six.

75-7256

S. WILLIAM GREEN, et al.,
Plaintiffs-Appellants,

v.

SANTA FE INDUSTRIES, INC., et al.,
Defendants-Appellees.

75-7404

ARNOLD MARSHEL,
Plaintiff-Appellant,

v.

AFW FABRIC CORPORATION, et al.,
Defendants-Appellees.

BARRY L. SWIFT,
Plaintiff-Appellant,

v.

CONCORD FABRICS, INCORPORATED, et al.,
Defendants-Appellees.

A poll of the judges in regular active service having been taken at the request of one of them, as to whether this action should be reheard en banc, and there being no majority in favor thereof, it is

Ordered that rehearing en banc is denied.

Chief Judge Kaufman and Circuit Judge Gurfein did not participate in the poll.

PER CURIAM:

This Court has denied en banc, not because we believe these cases are insignificant, but because they are of such extraordinary importance that we are confident the Supreme Court will accept these matters under its certiorari jurisdiction, as we correctly anticipated in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1020 (2d Cir. 1973), *vacated,* 417 U.S. 156 (1974).

Even under the best of circumstances, an en banc proceeding is often an unwieldy and cumbersome device generating little more than delay, costs, and continued uncertainty that can ill be afforded at a time of burgeoning calendars. A case in which Supreme Court resolution is inevitable should not be permitted to tarry in this Court for further intermediate action, at best, except when the views of this Court would be of real benefit to the Supreme Court. And, en banc is particularly inappropriate and unsatisfactory in the cases before us, since two of our active judges are disqualified from participating. With four senior judges sitting if these cases had been en banced, the law of the circuit might well be charted with the concurrence of only a minority of the active judges—defeating the very purpose the en banc procedure is designed to serve.

Moreover, the applications for certiorari that we expect inexorably to follow our action will not reach the Supreme Court devoid of the views of the judges of this Court. In contrast to the Pentagon Papers case—where this Court convened en banc but, due to urgent considerations of time, did not write opinions—these cases will go to the Supreme Court with full and thoughtful expositions of the opposing views of several members of this Court.

Accordingly, we speed these cases on their way to the Supreme Court as an exercise of sound, prudent, and resourceful judicial administration.

APPENDIX

In the

Supreme Court of the United States

October Term, 1976

No. 75-1753

Santa Fe Industries, Inc., et al.,

Petitioners

—v.—

S. William Green, et al.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI FILED JUNE 2, 1976
CERTIORARI GRANTED OCTOBER 4, 1976

INDEX TO APPENDIX

Relevant Docket Entries.

District Court

Date	*Filings—Proceedings*
Sept. 10, 1974	Filed complaint and issued summons
Nov. 6, 1974	Filed Defendants' affidavit and notice of motion to dismiss
Nov. 22, 1974	Filed amended complaint
Mar. 27, 1975	Filed Memorandum and Order. . . . This complaint has been amended once. Plaintiffs on the oral argument of this motion show no facts or contentions which they could assert if given further leave to serve a second amended complaint. In the absence of any such showing, this motion is granted, and the amended complaint is dismissed. . . . So Ordered. . . . Brieant, J.
Apr. 23, 1975	Filed Judgment and Order that Defendants' said motion is granted, that the amended complaint is dismissed and that plaintiffs recover nothing. Brieant, J. Judgment Entered
Apr. 24, 1975	Filed Plaintiffs' Notice of Appeal to USCA from final judgment entered . . . on 4-23-75 . . . Notices mailed on 4-29-75 to: Rogers & Wells, Esqs. and Davis, Polk & Wardwell, Esqs.

Relevant Docket Entries.

COURT OF APPEALS

Date	*Filing—Proceedings*
May 1, 1975	Action docketed.
May 28, 1975	Filed record (original papers of District Court).
November 5, 1975	Argument heard (by: Medina, Moore, Mansfield, C.JJ).
February 18, 1976	Judgment affirmed as to defendant Morgan Stanley & Co., reversed as to the other defendants, Medina, C.J. . . . concurring in separate opinion, Mansfield, C.J. . . . dissenting in separate opinion, Moore, C.J. . . . filed judgment.
March 3, 1976	Filed petition for rehearing and rehearing *en banc*.
March 10, 1976	Filed order denying Petition for Rehearing. . . . Petition for Rehearing *en banc* denied, *per curiam*.
April 7, 1976	Issued mandate (opinion, judgment, statement of costs).
June 10, 1976	Filed Notice of Filing Petition for Writ of Certiorari (Supreme Court Docket No. 75-1753).
October 12, 1976	Filed certified copy of Order of Supreme Court granting Petition for Writ of Certiorari.

Complaint.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Civil Action
No. 3915

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of LOUIS A. GREEN, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs,

—against—

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN, STANLEY & Co.,

Defendants.

COMPLAINT

For Equitable Relief, Damages, and Other Relief under Federal and State Law.

1. This is a civil action—derivative, class, and individual—for equitable and other relief. This Court has federal question jurisdiction under the Securities Exchange Act of 1934 and pendent jurisdiction over the State claim for breach of fiduciary obligation.

2. Plaintiffs were shareholders of Kirby Lumber Corporation, a Delaware corporation ("Kirby") at the time

of the transaction herein complained of and have continuously been and are now stockholders thereof; this action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have and plaintiffs filed and adequately represent the interests of the shareholders similarly situated in enforcing the rights of Kirby.

3. The class of stockholders of Kirby is so numerous that joinder of all is impracticable; the action presents questions of law and fact common to the class; the claims of plaintiffs herein are typical of the claims of the class; plaintiffs will fairly and adequately protect the interests of the class. This action falls within the Federal Rules of Civil Procedure, Rule 23(b)(1)(A) and (B) and (2) and (3).

4. Santa Fe Industries, Inc. ("Santa Fe") owns all the capital stock of Santa Fe Natural Resources, Inc. ("Resources") which owns approximately 95% of the capital stock of Kirby.

5. On July 31, 1974, Forest Products, Inc. ("FPI") was merged into Kirby with Kirby surviving the merger. The purpose of the merger was to cause Kirby to become a wholly owned subsidiary of Resources. In order to utilize the provisions of Section 253 of the General Corporation Law of the State of Delaware ("Delaware Corporation Law"), as described below, Resources caused FPI to be incorporated in Delaware on July 11, 1974. On July 29, 1974, FPI became the parent corporation of Kirby owning approximately 95% of the issued and outstanding Capital Stock of Kirby. On that date, FPI issued to Resources 1,000 shares of FPI Capital Stock in exchange for (i) 474,675 ½ shares of Kirby Capital Stock, and (ii) cash in the amount of $3,798,675 and (iii) the assumption of any other expenditures of FPI or Kirby

arising out of or resulting from the merger of FPI into Kirby. On July 30, 1974, the board of directors of FPI (which consisted of the same persons who are members of the board of directors of Resources) adopted a resolution of merger pursuant to Section 253 of the Delaware Corporation Law, providing that FPI would be merged into Kirby with Kirby surviving and that each share of Kirby stock not owned by FPI would represent only (i) a right to receive the amount of $150 per share in cash in exchange therefor, or (ii) a right to seek such appraisal for such stock as is available under Delaware law. Holders of shares of Kirby stock other than FPI, to wit, holders of 25,324 ½ shares, are entitled thereunder to receive the $150 per share payment in cash upon surrender of their certificates for such shares to the Kirby Paying Agent. Resources as sole stockholder of FPI approved the merger on July 30, 1974; no meeting of Kirby stockholders was required in connection with the FPI-Kirby merger. The merger became effective on July 31, 1974 when the Certificate of Ownership and Merger was filed with the Secretary of State of the State of Delaware.

6. Section 253 of the Delaware Corporation Law permits a parent corporation owning at least 90% of the capital stock of a subsidiary to cause a merger of the parent corporation into a subsidiary by the adoption of a resolution of merger by the parent's board of directors. Approval by the stockholders or the board of the subsidiary corporation is not required. However, approval by the stockholder of the parent corporation is necessary. Section 253 permits, in a merger pursuant to its provisions, the outstanding stock of the subsidiary other than the stock held by the parent to be exchanged for securities, cash, property or rights, other than stock in the surviving corporation. Thus, under a merger pursuant to Section 253, a parent corporation (FPI) owning at least 90% of the

stock of a subsidiary (Kirby) may cause the subsidiary (Kirby) to become a wholly owned subsidiary of the stockholder (Resources) of the parent (FPI) by providing in the resolution of merger that stockholders other than the parent shall receive cash in exchange for their shares.

7. The said value of $150 per share was based primarily on Kirby's book value, whereas based on fair market values the Kirby stock at the date of the merger was worth at least $772 per share. The difference of $311,000,000 ($622 per share) between the fair market value of Kirby's land and timber, alone, as per the defendants' own appraisal thereof at $320,000,000 and the $9,000,000 book value of said land and timber, added to the $150 per share, yields a value of at least $772 per share.

8. In addition, the majority stockholder has arranged the transaction as tax free to itself while imposing a capital gains tax on the minority stockholders.

9. The said short-form merger of controlling and controlled corporations, freezing out the minority stockholders of Kirby at the grossly undervalued price of $150 per share by the use of means or instrumentalities of interstate commerce including U.S. mail and telephone, is a manipulative and deceptive device in breach of SEC Rule 10b-5 and a breach of fiduciary obligation owed to Kirby and its minority stockholders. The corporate defendants participated in said breaches as principals and Morgan, Stanley & Co., a co-partnership, is liable as an accessory in that it knowingly assisted and facilitated such fraud by submitting an appraisal of the stock at $125 per share which said defendant knew was a gross undervaluation.

10. Plaintiffs have by notice mailed September 9, 1974 to Kirby, its directors, and controlling stockholder, and theretofore, objected to the said merger and its terms and demanded that the merger be rescinded or, failing that, that all the minority stockholders of Kirby be offered at least $772 per share plus a reasonable amount to compensate for the capital gains tax.

11. Santa Fe and Resources have at all material times owned 95% of the stock of Kirby and controlled and dominated its board of directors and dictated the terms of the wrongful merger. Demand on the board of directors and stockholders of Kirby for relief is therefore futile.

12. Plaintiffs have no adequate remedy at law.

Wherefore, plaintiffs pray for an order that their action in so far as brought as a class action may be maintained as such and demand judgment:

(a) That the merger aforesaid be set aside; or

(b) That the terms of the aforesaid merger be reformed so that they are just, fair and equitable; and

(c) That the Court give such other, further, and different relief as may be just, including damages, together with costs, disbursements and a reasonable fee for plaintiffs' attorneys.

Dated: September 9, 1974.

Leventritt Lewittes & Bender

By Sidney Bender
Sidney Bender
a member of the firm

Attorneys for the Plaintiffs
405 Lexington Avenue
New York, N.Y. 10017
Tel. 986-4080

(Verification
omitted in printing)

Notice of Motion to Dismiss.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Civ. 3915 (CLB)

S. WILLIAM GREEN, et al.,

Plaintiffs,

—against—

SANTA FE INDUSTRIES, INC., et al.,

Defendants.

SIRS:

PLEASE TAKE NOTICE, that upon the annexed affidavit of John C. Davis, sworn to October 31, 1974, with exhibit thereto, and upon the complaint and all prior proceedings herein, the undersigned will move this Court, at the United States Courthouse, Foley Square, New York, New York, Room 1105, on the 15th day of November, 1974, at 9:30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, for an Order, pursuant to Rules 12(b)(1) and (6), Federal Rules of Civil Procedure, dismissing the complaint herein for failure to state a claim upon which relief can be granted, and for such other and further relief as to the Court may seem just and proper.

PLEASE TAKE FURTHER NOTICE that, pursuant to Rule 9(c)(2) of the General Rules of this Court, answering

papers if any, must be served upon the undersigned not later than three days prior to the return day hereof.

Dated: New York, New York
November 4, 1974.

Yours, etc.

ROGERS & WELLS

By GUY C. QUINLAN
Member of the Firm
Attorneys for Defendants
Santa Fe Industries, Inc.,
Santa Fe Natural Resources, Inc.
and Kirby Lumber Corporation
200 Park Avenue
New York, N. Y. 10017
Tel. No. (212) 972-7000

DAVIS, POLK & WARDWELL

By

Member of the Firm
Attorneys for Defendant
Morgan Stanley & Co.
One Chase Manhattan Plaza
New York, N. Y. 10017
Tel. No. (212) HA 2-3400

To: LEVENTRITT LEWITTES & BENDER, Esqs.
Attorneys for Plaintiffs
405 Lexington Avenue
New York, N. Y. 10017
Tel. No. (212) 986-4080

Affidavit of John C. Davis.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Civil Action
No. 3915 (CLB)

AFFIDAVIT

S. William Green, Evelyn Green, et al.,

Plaintiffs,

—against—

Santa Fe Industries, Inc., et al.,

Defendants.

STATE OF ILLINOIS } SS.
COUNTY OF COOK }

John C. Davis, being duly sworn, deposes and says,

1. I am a Vice President of Santa Fe Industries, Inc., one of the defendants in the above action. I make this affidavit in support of defendants' motion to dismiss the complaint herein.

2. Annexed to this Affidavit, as Exhibit A, is a true copy of the Notice of Merger and Information Statement which was circulated to shareholders in connection with the merger of Forest Products, Inc., into the Kirby Lumber Corporation. A complete copy of the document attached hereto as Exhibit A, including the Exhibits thereto, was mailed to each shareholder of record of Kirby Lumber Corporation on August 1, 1974.

3. As stated at page 11 of Exhibit A hereto, a complete copy of the appraisal by Appraisal Associates, referred to in the Information Statement, has been available for inspection, by shareholders of Kirby Lumber Corporation, during normal business hours at the offices of Santa Fe Natural Resources, Inc. in Chicago, Illinois.

4. None of the Plaintiffs has tendered any of the stock of Kirby Lumber Corporation. On August 21, 1974 the plaintiffs made a demand for appraisal of their Kirby stock. By letter dated September 9, 1974 they purported to withdraw their demand for a statutory appraisal. Both of these events antedated the filing of the lawsuit on September 10, 1974.

John C. Davis

Sworn to before me this
31st day of October 1974.

P. J. Feeney
Notary Public
My Commission Expires May 29, 1977

Exhibit A to Davis Affidavit.

NOTICE OF MERGER
OF
FOREST PRODUCTS, INC.
INTO
KIRBY LUMBER CORPORATION

TO THE HOLDERS OF CAPITAL STOCK
OF KIRBY LUMBER CORPORATION:

NOTICE IS HEREBY GIVEN pursuant to Section 253(d) of the General Corporation Law of the State of Delaware that the merger of Forest Products, Inc. ("FPI") into Kirby Lumber Corporation (the "Surviving Corporation"), pursuant to a resolution of merger duly adopted by FPI on July 30, 1974, became effective on July 31, 1974.

Under the terms and conditions of the merger and the applicable provisions of Delaware law, each share of Kirby Lumber Corporation Capital Stock outstanding at the time of the merger was cancelled upon the merger becoming effective, and each such share not owned by FPI now represents only (i) a right to receive from the Surviving Corporation One Hundred Fifty ($150) dollars per share, in cash, upon surrender of the certificates representing such shares by the holders thereof to the Surviving Corporation's Paying Agent, or (ii) a right to seek such appraisal for such stock as is available under Delaware law (see below).

TO RECEIVE THEIR $150 PER SHARE PAYMENT UNDER THE TERMS OF MERGER, STOCKHOLDERS OF KIRBY LUMBER CORPORATION MUST COMPLETE THE ENCLOSED LETTER OF TRANSMITTAL AND EITHER PRESENT THEIR STOCK CERTIFICATES AND THE LETTER OF TRANSMITTAL

Exhibit A to Davis Affidavit.

TO THE SURVIVING CORPORATION'S PAYING AGENT IN PERSON OR BY MAIL AT THE FOLLOWING ADDRESS:

Harris Trust and Savings Bank
Stock Transfer Division
111 West Monroe
Chicago, Illinois 60690

If a certificate is registered in a name other than that of the person surrendering the certificate, or if the check in payment for the shares is to be made payable to someone other than the person surrendering the certificate, then the certificates must be properly endorsed for transfer or be accompanied by properly executed stock powers, and the signature on the endorsement or the stock powers must be guaranteed by a bank or trust company having an office or correspondent in the City of Chicago, Illinois or by a firm having membership in the New York, Midwest or Pacific Coast Stock Exchanges.

Sections 253(d) and 262(a) through (j) of the General Corporation Law of Delaware, a copy of which may be found in Exhibit A to the attached Information Statement, provides, for stockholders of Kirby Lumber Corporation unwilling to accept the aforesaid per share payment, a procedure for seeking an appraisal of the value of their shares, exclusive of any element of value arising from the expectation or accomplishment of the merger. ANY STOCKHOLDER ELECTING TO EXERCISE HIS OR HER RIGHT TO SEEK AN APPRAISAL MUST, WITHIN 20 DAYS AFTER THE DATE OF MAILING OF THIS NOTICE, WHICH WAS AUGUST 1, 1974, DEMAND IN WRITING FROM THE SURVIVING CORPORATION THE PAYMENT OF THE VALUE OF HIS OR HER STOCK. THUS, ANY STOCKHOLDER

Exhibit A to Davis Affidavit.

ELECTING TO EXERCISE THE RIGHT OF APPRAISAL MUST GIVE WRITTEN NOTICE THEREOF BY AUGUST 21, 1974 TO THE SURVIVING CORPORATION. ANY SUCH NOTICE MAY BE SENT TO THE PAYING AGENT AT THE ADDRESS GIVEN ABOVE OR TO THE SURVIVING CORPORATION AT THE ADDRESS GIVEN IN THE ATTACHED INFORMATION STATEMENT (SEE "GENERAL INFORMATION" IN THE INFORMATION STATEMENT). Reference also should be made to "Appraisal Rights" in the Information Statement and Exhibit A thereto for a description of this procedure.

KIRBY LUMBER CORPORATION
(the Surviving Corporation)

DATED: July 31, 1974

Exhibit A to Davis Affidavit.

INFORMATION STATEMENT MERGER OF FOREST PRODUCTS, INC. INTO KIRBY LUMBER CORPORATION

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Exhibit A to Davis Affidavit.

INFORMATION STATEMENT
MERGER OF FOREST PRODUCTS, INC.
INTO KIRBY LUMBER CORPORATION

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Exhibit A to Davis Affidavit.

INFORMATION STATEMENT
MERGER OF FOREST PRODUCTS, INC.
INTO KIRBY LUMBER CORPORATION

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July 31, 1974

INFORMATION STATEMENT
MERGER OF FOREST PRODUCTS, INC.
INTO KIRBY LUMBER CORPORATION

GENERAL INFORMATION

This Information Statement is being furnished to stockholders of Kirby Lumber Corporation, a Delaware corporation ("Kirby" or "Surviving Corporation"), in connection with the merger of Forest Products, Inc., a Delaware corporation ("FPI"), into Kirby, with Kirby the Surviving Corporation. As a result of the merger, which became effective on July 31, 1974, Kirby became a wholly owned subsidiary of Santa Fe Natural Resources, Inc. ("Resources"), which in turn is a wholly owned subsidiary of of Santa Fe Industries, Inc. ("Santa Fe"). Pursuant to the terms of the merger, stockholders of Kirby other than FPI ("Minority Stockholders") are entitled to $150 in cash for each share of Kirby stock. A copy of the Certificate of Ownership and Merger as filed with the Secretary of State of the State of Delaware is attached hereto as Exhibit B.

Under Delaware law, each Minority Stockholder of Kirby has the right to seek an appraisal of the value of his or her stock. In order to perfect such right of appraisal, a Minority Stockholder must make a demand in writing on the Surviving Corporation, directed to the Paying Agent or to Kirby at the address given below, within 20 days after the date of mailing of the preceding Notice of Merger, which was mailed on August 1, 1974. This Information Statement sets forth a description of the merger and includes information concerning Kirby, its business and properties together with earnings and financial statements and the results of certain appraisals made respecting

Kirby. Each of the Minority Stockholders of Kirby is urged to read this material carefully in making his or her determination to seek or not to seek an appraisal pursuant to the Delaware law. See "Appraisal Rights" and Exhibit A.

The addresses and telephone numbers of Kirby, Resources, and Santa Fe are set forth in the following table:

Kirby Lumber Corporation
P. O. Box 1514
Houston, Texas 77001
(713) 225-0421

Santa Fe Natural Resources, Inc.
224 South Michigan Avenue
Suite 1426
Chicago, Illinois 60604
(312) 427-2232

Santa Fe Industries, Inc.
224 South Michigan Avenue
Suite 1015
Chicago, Illinois 60604
(312) 427-4900, Ext. 247

SUMMARY OF MERGER

On July 31, 1974, FPI was merged into Kirby with Kirby surviving the merger. The purpose of the merger was to cause Kirby to become a wholly owned subsidiary of Resources. In order to utilize the provisions of Section 253 of the General Corporation Law of the State of Delaware ("Delaware Corporation Law"), as described below, Resources caused FPI to be incorporated in Delaware on July 11, 1974. On July 29, 1974, FPI became the parent corporation of Kirby owning approximately 95% of the issued and outstanding Capital Stock of Kirby. On that date, FPI issued to Resources 1,000 shares of FPI Capital Stock in exchange for (i) 474,675½ shares of Kirby Capital

Stock, and (ii) cash in the amount of $3,798,675 and (iii) the assumption of any other expenditures of FPI or Kirby arising out of or resulting from the merger of FPI into Kirby. On July 30, 1974, the board of directors of FPI (which consisted of the same persons who are members of the board of directors of Resources) adopted a resolution of merger pursuant to Section 253 of the Delaware Corporation Law, providing that FPI would be merged into Kirby with Kirby surviving and that each share of Kirby stock not owned by FPI would represent only (i) a right to receive the amount of $150 per share in cash in exchange therefor, or (ii) a right to seek such appraisal for such stock as is available under Delaware law—(see "Appraisal Rights"). Holders of shares of Kirby stock other than FPI are entitled to receive the $150 per share payment in cash upon surrender of their certificates for such shares to the Paying Agent. See "Paying Agent." Resources as sole stockholder of FPI approved the merger on July 30, 1974; no meeting of Kirby stockholders was required in connection with the FPI-Kirby merger. The merger became effective on July 31, 1974 when the Certificate of Ownership and Merger, in the form attached as Exhibit B, was filed with the Secretary of State of the State of Delaware.

Section 253 of the Delaware Corporation Law

Section 253 of the Delaware Corporation Law permits a parent corporation owning at least 90% of the capital stock of a subsidiary to cause a merger of the parent corporation into the subsidiary by the adoption of a resolution of merger by the parent's board of directors. See Exhibit A. Approval by the stockholders or the board of the subsidiary corporation is not required. However, approval by the stockholder of the parent corporation is necessary. Section 253 permits, in a merger pursuant to its provisions, the outstanding stock of the subsidiary other than the stock held by the parent to be exchanged for securities, cash, property or rights, other than stock in the surviving corporation. Thus, under a merger pursuant to Section 253, a parent corporation owning at least 90% of the stock of a subsidiary may cause the subsidiary to become a wholly owned subsidiary of the stockholder of the parent by providing in the resolution of merger that stockholders other than the parent shall receive cash in exchange for their shares.

Paying Agent

Harris Trust and Savings Bank has been designated as the Surviving Corporation's paying agent ("Paying Agent") to handle the exchange of stock certificates for cash due pursuant to the merger. MINORITY STOCKHOLDERS, IN ORDER TO RECEIVE THEIR $150 PER SHARE PAYMENT UNDER THE TERMS OF MERGER, MUST COMPLETE THE ENCLOSED LETTER OF TRANSMITTAL AND EITHER PRESENT THEIR STOCK CERTIFICATES AND THE LETTER OF TRANSMITTAL TO THE PAYING AGENT IN PERSON OR BY MAIL AT THE FOLLOWING ADDRESS:

Harris Trust and Savings Bank
Stock Transfer Division
111 West Monroe Street
Chicago, Illinois 60690

All charges and expenses of the Paying Agent will be paid by Resources. If a certificate is registered in a name other than that of the person surrendering the certificate, or if the check in payment for the shares is to be made payable to someone other than the person surrendering

the certificate, then the certificate must be properly endorsed for transfer or be accompanied by properly executed stock powers, and the signature on the endorsement or the stock powers must be guaranteed by a bank or trust company having an office or correspondent in the City of Chicago, Illinois or a firm having membership in the New York, Midwest or Pacific Coast Stock Exchanges.

Appraisal Rights

Minority Stockholders who object to the consideration provided under the terms of the merger may seek an appraisal of such stock under the procedures of the Delaware Corporation Law. Subsections 253(d) and 262(c) of the Delaware Corporation Law, copies of which are attached as Exhibit A, require the surviving corporation of a Section 253 merger to notify within 10 days after the effective date each stockholder that the merger has become effective. The notice must be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any stockholder may, within 20 days after the date of mailing of such notice, demand in writing from such surviving corporation payment of the value of his stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If during a period of 30 days following the 20 day period, the corporation and the stockholder fail to agree upon the value of such stock, any such stockholder or the surviving corporation may demand a determination of the value of the stock by a Court appointed appraiser by filing a petition with the Court of Chancery of Delaware within four months after the expiration of the 30 day period. Procedures concerning the appraisal proceedings are outlined in Subsections 262(d), (e) and (f) of the Delaware Corporation Law. See Exhibit A.

THE NOTICE OF MERGER WHICH IS ATTACHED AND PRECEDES THIS INFORMATION STATEMENT PROVIDES NOTICE TO THE STOCKHOLDERS REQUIRED BY SECTION 253(d). THIS INFORMATION STATEMENT WAS MAILED ON AUGUST 1, 1974, AND THEREFORE MINORITY STOCKHOLDERS HAVE 20 DAYS, UNTIL AUGUST 21, 1974, TO DEMAND IN WRITING THE PAYMENT OF THE VALUE OF THEIR STOCK.

The applicable provisions of the Delaware Corporation Law are set out in Exhibit A to this Information Statement, and the foregoing brief description does not purport to be a complete summary of these provisions.

Exhibit A to Davis Affidavit.

CAPITALIZATION

The following table sets forth the actual capitalization of Kirby at June 30, 1974 and the pro forma capitalization of Kirby (see Note 1 below) which gives effect to the merger described in "Summary of Merger" as if such merger occurred as of June 30, 1974.

	Actual	Pro Forma (1)
	(In Thousands)	
NOTES PAYABLE		
Santa Fe Industries, Inc. (2)	$ 1 600	$ 1 600
Other (3)	2 250	2 250
Total Notes Payable	3 850	3 850
STOCKHOLDERS' EQUITY		
Capital Stock, $1 par value:		
Authorized—750,000 shares		
Issued and outstanding—		
Actual, 500,000 shares	500	
Pro forma, 1,000 shares (1)		1
Paid-in Capital (1)	5 099	5 598
Retained Income	31 428	31 428
Total Stockholders' Equity	37 027	37 027
Total Notes Payable and Stockholders' Equity	$ 40 877	$ 40 877

NOTES:

(1) Upon effectiveness of the merger, pursuant to the terms thereof described in "Summary of Merger," each of the previously outstanding shares of Kirby Capital Stock was cancelled and 1,000 new shares were issued to Resources. The excess of the par value of the previously outstanding Capital Stock (500,000 shares) over the par value of the presently outstanding Capital Stock (1,000 shares) was credited to Paid-in Capital.

Pursuant to the merger with FPI, Kirby obtained $3,798,675 in cash to be paid to the holders of Kirby's previously outstanding Capital Stock other than FPI. The only other assets of FPI at the date of merger were 474,675½ shares of previously outstanding Kirby Capital Stock.

Exhibit A to Davis Affidavit.

(2) Under an interim credit agreement with Santa Fe Industries, Inc. Kirby may borrow up to $15,000,000 to provide interim construction financing for new plywood and particleboard facilities. As of June 30, 1974, $1,600,000 had been borrowed. It is intended that borrowings under this agreement are to be repaid with the proceeds of a term loan from a non-affiliated lender to be arranged upon completion of construction of the new facilities. Otherwise, the aggregate principal amount is payable on March 15, 1979. Interest is charged at ½ of 1% over the prime rate.

(3) The note payable for $2,250,000 is unsecured, bears interest at ¾ of 1% above the prime rate, and is payable on June 8, 1978.

KIRBY LUMBER CORPORATION
STATEMENT OF INCOME AND RETAINED INCOME

The following Statement of Income and Retained Income of Kirby Lumber Corporation ("Kirby"), insofar as it relates to the five years ended December 31, 1973, has been examined by Price Waterhouse & Co., independent accountants, whose opinion thereon appears elsewhere in this Information Statement. In the opinion of Kirby management, all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results of operations for the six months ended June 30, 1973 and 1974 have been included. The results of operations for the six months ended June 30, 1974 are not necessarily indicative of the results of operations for the full year 1974 (see "Operations for 1974" for information regarding anticipated results of operations for the last half of 1974). This statement should be read in conjunction with the financial statements and notes thereto of Kirby appearing elsewhere in this Information Statement. Numerical note references relate to notes to financial statements on pages 64a-66a.

	Year Ended December 31					Six Months Ended June 30	
	1969	1970	1971	1972 (In Thousands)	1973	1973 (unaudited)	1974 (unaudited)
REVENUES							
Manufactured products, net	$17 403	$14 709	$18 673	$22 970	$25 636	$13 419	$13 988
Oil sales and royalties	1 320	954	964	945	1 304	789	531
Timber and land sales	962	564	535	548	558	265	2 517
Interest income	520	641	325	322	696	252	187
Other income	156	214	253	314	233	90	213
	20 361	17 082	20 750	25 099	28 427	14 815	17 436

	Year Ended December 31					Six Months Ended June 30	
	1969	1970	1971	1972 (In Thousands)	1973	1973 (unaudited)	1974 (unaudited)
COSTS AND EXPENSES							
Cost of sales	9 517	9 608	11 852	13 777	13 537	6 483	9 108
Depreciation and depletion (Note 1)	1 372	1 565	1 858	2 105	2 012	929	1 036
General, administrative and selling expenses	2 118	2 037	2 217	2 657	3 487	1 553	1 683
Taxes, other than federal income	537	625	734	852	798	453	534
	13 544	13 835	16 661	19 391	19 834	9 418	12 361
INCOME BEFORE FEDERAL INCOME TAX	6 817	3 247	4 089	5 708	8 593	5 397	5 075
FEDERAL INCOME TAX (Note a)							
Currently payable	1 792	1 198	1 284	1 542	2 523	1 875	1 646
Deferred	301	—	—	36	68	91	—
	2 093	1 198	1 284	1 578	2 591	1 966	1 646
NET INCOME (Note a)	4 724	2 049	2 805	4 130	6 002	3 431	3 429
RETAINED INCOME AT BEGINNING OF PERIOD	15 789	19 013	19 562	20 867	23 497	23 497	27 999
DIVIDENDS PAID ($3.00 per share)	(1 500)	(1 500)	(1 500)	(1 500)	(1 500)	—	—
RETAINED INCOME AT END OF PERIOD	$19 013	$19 562	$20 867	$23 497	$27 999	$26 928	$31 428
NET INCOME PER SHARE OF CAPITAL STOCK	$ 9.45	$ 4.10	$ 5.61	$ 8.26	$ 12.00	$ 6.86	$ 6.86

KIRBY LUMBER CORPORATION
NOTES TO STATEMENT OF INCOME AND RETAINED INCOME

(All information relating to the six months ended June 30, 1973 and 1974 is unaudited.)

(a) The taxable income of Kirby is included in a consolidated federal income tax return filed by Santa Fe Industries, Inc., the indirect owner of 94.9% of the outstanding capital stock of Kirby (see Note 2). Under an income tax allocation agreement between Santa Fe Industries, Inc. and the members of the consolidated group, Kirby makes payments of federal income tax to its parent on the basis of the tax that would be payable if a separate return were filed by Kirby. Kirby computes its separate return federal income tax liability using an alternative tax computation method giving effect to special tax provisions applicable to companies engaged in timber operations. This resulted in Kirby not realizing tax benefits, principally from the use of accelerated depreciation methods, of \$156,000 in 1970, \$250,000 in 1971, \$172,000 in 1972, \$165,000 in 1973 and \$281,000 in the six months ended June 30, 1974. Nevertheless, under the aforementioned agreement, Kirby will be reimbursed for any excess of tax over book deduction benefits not realized (\$770,000 at December 31, 1973 and \$1,051,000 at June 30, 1974) if future operations result in Kirby paying more federal income tax than it would have paid if the excess deductions for tax purposes had not been claimed.

The following table reconciles the difference between total federal income tax and the anticipated tax computed by applying the statutory tax rate to income before federal income tax:

	Year Ended December 31 (In Thousands)					Six Months Ended June 30	
	1969	1970	1971	1972	1973	1973	1974
Income before federal income tax	\$ 6 817	\$ 3 247	\$ 4 089	\$ 5 708	\$ 8 593	\$ 5 397	\$ 5 075
Statutory tax rate	52.8%	49.2%	48%	48%	48%	48%	48%
Anticipated tax at statutory rate	3 599	1 598	1 963	2 740	4 125	2 591	2 436
Less:							
Capital gain income (principally from use of alternative tax computation method)	1 242	326	549	895	1 427	597	326
Investment tax credits	30	—	40	104	79	43	480
Other	234	74	90	163	28	(15)	(16)
	1 506	400	679	1 162	1 534	625	790
Total federal income tax	\$ 2 093	\$ 1 198	\$ 1 284	\$ 1 578	\$ 2 591	\$ 1 966	\$ 1 646
Effective tax rate	30.7%	36.9%	31.4%	27.6%	30.2%	36.4%	32.4%

Exhibit A to Davis Affidavit.

If the provision for federal income tax for the six months ended June 30, 1973 had been computed in accordance with Paragraph 19 of Opinion 28 issued by the American Institute of Certified Public Accountants, which became effective January 1, 1974, such provision would have been lower, and net income would have been greater, by $336,000 ($.67 per share) based on the actual effective federal income tax rate for 1973 of 30.2%.

(b) Kirby is a participant in the Santa Fe Railway System Retirement Plan whereby salaried employees are eligible for pension benefits. Expense under this plan amounted to $180,000 in 1969, $39,000 in 1970, $159,000 in 1971, $174,000 in 1972, $176,000 in 1973, $83,000 in the six months ended June 30, 1973 and $102,000 in the six months ended June 30, 1974. Pension costs accrued under the plan are currently not being funded. All vested benefits under the plan are fully funded.

Kirby adopted a noncontributory retirement plan in 1971 covering substantially all hourly employees. The cost of this plan, which includes amortization of past service costs over 10 years, amounted to $41,000 in 1971, $65,000 in 1972, $67,000 in 1973, $33,000 in the six months ended June 30, 1973 and $50,000 in the six months ended June 30, 1974. Kirby's policy is to fund pension costs accrued under this plan.

In 1973, Kirby adopted an incentive compensation plan for certain key management employees. Under this plan, additional compensation is available to the extent of ten percent of the excess of income for the year, as defined, over the amount budgeted at the beginning of the year. The cost of this plan amounted to $268,000 in 1973 and $108,000 and $42,000 in the six months ended June 30, 1973 and 1974, respectively.

(c) Supplementary income statement information:

Exhibit A to Davis Affidavit.

	Year Ended December 31 (In Thousands)					Six Months Ended June 30	
	1969	1970	1971	1972	1973	1973	1974
Maintenance and repairs	$ 1 185	$ 1 614	$ 2 080	$ 2 688	$ 3 246	$ 1 490	$ 1 896
Taxes, other than federal income tax							
Social Security	254	269	320	346	398	206	258
Real estate and personal property	680	777	886	1 039	1 016	566	641
Other	69	89	110	138	155	82	79
Rents	23	31	45	81	93	41	72
Advertising costs	54	81	82	143	180	29	51

Exhibit A to Davis Affidavit.

The decrease in net income for 1970 from that reported in 1969 was principally attributable to sharp declines in building material prices which resulted from depressed residential construction volumes. Oil and gas bonuses and land sales were also at levels lower than the prior year.

Net income increased in 1971 from the 1970 level principally as a result of improved prices for lumber and plywood coupled with higher volume of products shipped from expanded production facilities.

In 1972 further volume increases attributable to the full year's operation of expanded plywood facilities and further product price increases due to the higher level of residential construction activity contributed to improved net income over that of 1971.

The increase in net income from 1972 to 1973 resulted primarily from greatly escalated prices for forest products caused by the peak demand for residential construction partially offset by declines in production brought on by flooding on parts of Kirby's timberlands and a two week strike at the Silsbee complex. Improved proceeds from oil and gas leases and higher interest rates on temporary investments also contributed to improved net income.

In the six months ended June 30, 1974, net income was approximately equal to that of the corresponding period of the prior year. (See Note a to Statement of Income and Retained Income for effect on net income for the six months ended June 30, 1973 of federal income tax rates.) Increased sales of saw logs under timber contracts offset declining profits of manufactured products, where labor and material cost increases were greater than revenue increases.

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Exhibit A to Davis Affidavit.

RECENT PURCHASES OF KIRBY STOCK BY AFFILATES OF SANTA FE INDUSTRIES, INC. AND THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY

As a result of the reorganization of the predecessor of Kirby Lumber Corporation in 1936, a wholly owned subsidiary of The Atchison, Topeka and Santa Fe Railway Company ("Railway") became the owner of approximately 60% of the Capital Stock of Kirby issued and outstanding at the time. Since then various affiliates of Railway and Santa Fe, which now owns all the stock of Railway, have purchased shares of Kirby stock. In 1967 an affiliate of Railway offered to purchase Kirby shares at a price of $65 per share from stockholders of Kirby. As a result, 27,979½ shares were tendered and acquired for $65 per share.

The following summary shows the prices paid by affiliates of Santa Fe and Railway for shares of Kirby stock from 1968 to the present:

Year	Number of Shares Purchased	Price Per Share
1968	500	$65.00
1969	88	85.00
1969	1,200	92.50
1970	25	84.00
1970	844	85.00
1971	147	85.00
1972	100	85.00
1972	100	90.00
1973	141	85.00
1973	310	88.00
1973	1,446	90.00

No stock has been acquired by affiliates of Santa Fe and Railway since October, 1973.

The number of issued and outstanding shares of Kirby Capital Stock not owned by Resources or its predecessors which have been available for trading has been small. Information concerning market prices in transactions other than those involving affiliates of Santa Fe and Railway is not available for inclusion in this Information Statement. For the period covered by the summary above, Santa Fe, Railway and their affiliates are not aware of any person or persons who have acted as a "market maker" for Kirby stock.

DIVIDENDS

During the past five years, 1969 through 1973, Kirby has declared and paid annual dividends in December of $3 per share. No dividends have been declared or paid in 1974.

OPINION OF MORGAN STANLEY & CO.

In response to a request from Sante Fe Industries, Inc., Morgan Stanley & Co., an investment banking firm, has furnished an opinion as to the present fair market value of a share of Capital Stock of Kirby. Based on studies of Kirby, its financial position, operating history and appraisals of its assets and mineral holdings, and comparisons with other publicly held companies in the forest products industry, and on the assumptions that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly held companies, it is Morgan Stanley & Co.'s opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

A copy of their opinion letter is reproduced in full at Exhibit C.

In the past Morgan Stanley & Co. has prepared studies for and provided financial advice to Railway and Santa Fe. Morgan Stanley & Co. is to be paid a fee of $125,000 by Santa Fe for preparing its opinion, plus out-of-pocket expenses of $2,500. Members of the firm of Morgan Stanley & Co., together with their immediate families, own no securities of Santa Fe or Kirby.

ASSETS APPRAISALS

Appraisal of Land, Timber, Buildings and Machinery

In response to a request by Santa Fe Industries Inc., Appraisal Associates of Kansas City, Missouri conducted an appraisal of the land, exclusive of minerals, and the timber, buildings and machinery belonging to Kirby as of December 31, 1973. Based upon information supplied by Kirby, inspection of the Kirby properties, and information and date supplied by knowledgeable sources, it is the judgment of Appraisal Associates that the market value of the land, exclusive of minerals, and the timber, buildings and machinery belonging to Kirby as of December 31, 1973 was $320,000,000.

The letter dated February 19, 1974 from Appraisal Associates setting forth their opinion is reproduced in full at Exhibit D. A complete copy of the appraisal is available for inspection by Minority Stockholders during normal business hours at the offices of Santa Fe Natural Resources, Inc., 224 South Michigan Avenue, Suite 1426, Chicago, Illinois 60604.

Before conducting this appraisal, Appraisal Associates had not provided any services for Santa Fe or its affiliates.

Appraisal Associates has been paid a fee of $32,018.81 by Santa Fe for preparing their appraisal, plus out-of-pocket expenses of $5,977.41. Members of the firm of Appraisal Associates do not hold any securities issued by Santa Fe or Kirby.

This appraisal was considered by Morgan Stanley & Co. when preparing their opinion. See "Opinion of Morgan Stanley & Co."

Inventory of Kirby Forests

Resource Management Services, Inc., professional foresters, assisted Appraisal Associates in estimating the contribution of the timber in Kirby forests primarily by updating an inventory of Kirby forests previously taken as of January 1, 1970. The updated inventory as of January 1, 1974 showed Kirby to have a total of 2,904,213 cords of pulpwood and 2,518,870.4 MBF of sawtimber.

For its services Resource Management Services, Inc. has been paid a fee of $15,099.90 plus out-of-pocket expenses of $4,512.79.

Appraisal of Mineral Rights

In response to a request by Santa Fe Industries, Inc., Riggs and Associates, petroleum reservoir consultants, conducted an appraisal of the producing oil and gas royalty interests of Kirby and of its mineral ownership in nonproducing properties in Texas and Louisiana as of January 1, 1974. Based upon forecasts of future gross and net oil and gas production, revenue, expenses, and net revenue for each producing royalty interest, current oil and gas prices in effect, and the cash flow stream, Riggs and Associates are of the opinion that the reasonable market value of Kirby's producing oil and gas reserves is $1,856,000. Based upon tract-by-tract estimates, proximities

of tracts to recent activity, economic models, and verification through examination of historical revenues derived by Kirby from lease bonuses and rentals for nonproducing leases, and assuming that the market evaluation of around 1400 separate tracts can be considered valid only in the aggregate, Riggs and Associates are of the opinion that the reasonable value of Kirby's nonproducing mineral interests is $6,368,000.

The opinion letter with tables is reproduced in full at Exhibit E.

This appraisal was considered by Morgan Stanley & Co. when preparing their opinion. See "Opinion of Morgan Stanley & Co."

Mr. Roy Riggs of Riggs and Associates has had previous dealings with Santa Fe and its subsidiaries. As an employee and later president of James A. Lewis Engineering, Inc. ("Lewis"), Mr. Riggs prepared periodic performance reports and special reports for which Lewis received substantial fees. Lewis' services were first used by a Santa Fe affiliate in 1963. In the Fall of 1973 Mr. Riggs left Lewis to start Riggs and Associates and entered into a consulting agreement with Resources under which Riggs and Associates would provide consulting services on a fixed man hour basis in return for a monthly fee of $5,500 plus out-of-pocket expenses. Fees paid to Riggs and Associates attributable to the preparation of this appraisal are $5,965.75 plus $1,149.37 for out-of-pocket expenses. Neither Lewis nor Mr. Riggs has done any previous work concerning Kirby or its properties. Mr. Riggs presently owns 100 shares of Santa Fe Common Stock and no shares of Kirby.

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BUSINESS AND PROPERTIES OF KIRBY

GENERAL

Kirby is engaged primarily in the manufacture and marketing of lumber, plywood, and other wood products. It also receives income from its mineral holdings, sales of timber and land, and other sources.

CONTRIBUTION BY BUSINESS ACTIVITIES

The table on the following page summarizes (1) revenues, including revenues from manufactured products by each class of similar products, and (2) income before federal income tax, of each of the business activities of Kirby for the five years ended December 31, 1973 and the six months ended June 30, 1973 and 1974. Sales of manufactured products during these periods accounted for approximately 80 to 92% of total revenues.

TIMBER AND MANUFACTURED PRODUCTS

General

Kirby manufactures and sells plywood and lumber to industries and wholesalers principally in Texas and the South. Kirby owns and operates a sawmill, wood preserving and plywood plant at Silsbee, Texas and an industrial wood component plant in Cleveland, Texas. A plywood plant near Bon Wier, Texas and a particleboard plant at Silsbee, Texas are under construction.

Kirby owns 557,223 acres of forest lands and manages another 75,000 acres owned by a wholly owned subsidiary of Resources. See "Certain Transactions with Santa Fe

Industries, Inc. and Its Subsidiaries". From this base, Kirby primarily harvests pine for conversion in its own facilities to lumber, plywood and by-products. Some pine is sold as pulpwood to outside users in eastern Texas and southernwestern Louisiana. Kirby continues to manage with a sustained yield forest management system under which more timber is grown than is harvested. Under this system approximately 98.5% of the net annual growth of pine saw timber is cut. The accelerated reforestation program initiated in 1972 is being continued and 52,000 acres were subjected to various forms of reforestation measures in 1973. Kirby also has a Seed Tree Orchard where genetically superior strains of trees are being grown for reforestation activities in the 1980's.

Kirby conducts most of its logging operations on a contract basis with independent logging operators.

Exhibit A to Davis Affidavit.

KIRBY LUMBER CORPORATION
CONTRIBUTION BY BUSINESS ACTIVITIES

	Year Ended December 31					Six Months Ended June 30	
	1969	1970	1971	1972	1973	1973	1974
	(In Thousands)						
REVENUES							
Manufactured products, net							
Lumber	$ 9 854	$ 8 091	$ 8 798	$ 10 008	$ 10 546	$ 5 320	$ 5 882
Plywood	4 637	4 135	6 435	8 874	10 276	5 951	5 343
Other	2 912	2 483	3 440	4 088	4 814	2 148	2 763
Total	17 403	14 709	18 673	22 970	25 636	13 419	13 988
Oil sales and royalties	1 320	954	964	945	1 304	789	531
Timber and land sales	962	564	535	548	558	265	2 517
Interest income	520	641	325	322	696	252	187
Other income	156	214	253	314	233	90	213
	$ 20 361	$ 17 082	$ 20 750	$ 25 099	$ 28 427	$ 14 815	$ 17 436
INCOME BEFORE FEDERAL INCOME TAX							
Manufactured products	$ 3 899	$ 910	$ 2 052	$ 3 598	$ 5 831	$ 4 010	$ 1 646
Oil sales and royalties	1 320	954	964	945	1 304	789	531
Timber and land sales	922	528	495	529	529	256	2 498
Interest income	520	641	325	322	696	252	187
Other income	156	214	253	314	233	90	213
	$ 6 817	$ 3 247	$ 4 089	$ 5 708	$ 8 593	$ 5 397	$ 5 075

Exhibit A to Davis Affidavit.

Operations During 1973

In 1973, Kirby's revenues totaled $28.4 million, 13% above 1972 revenues of $25.1 million. Net income for 1973 was $6.0 million ($12.00 per share), 45% greater than 1972's $4.1 million ($8.26 per share). Increased revenues and net income in 1973 resulted in part from increased prices for Kirby products permitted under Phase III of the Economic Stabilization Program in early 1973 and, additionally, from peak levels of residential construction activity during the first nine months of the year. Average prices of lumber and plywood sold in 1973 increased 36.2% and 17.7% respectively, over 1972 prices, compensating for a decline in total production caused by the combined effect of a two-week strike at the Silsbee, Texas plant in mid-year and unprecedented flooding throughout the year on its forest lands. Housing starts, however, declined sharply in late 1973.

Major capital programs in reforestation, construction and diversification brought total capital expenditures to $11.0 million in 1973. See "Recent Developments."

Operations During 1974

Kirby's net income for the first six months of 1974 was $3.4 million, virtually identical to net income for the first six months of 1973. A substantial decline from this level is expected, however, for the remainder of 1974 for two principal reasons. First, the decline in income from manufactured products during the first six months of 1974 from the first half of 1973 (see "Contribution by Business Activities") is expected to continue. During the first half of 1974 this decline was offset by sales of standing timber. Because essentially all of Kirby's 1974 timber sales were completed and paid for as of June 30, 1974, minimal income is anticipated from this source during the second

half of 1974. Secondly, the declining levels of housing starts are expected to deteriorate further in the second half of 1974, which should narrow profit margins from manufacturing operations. Prices for lumber, plywood, and particleboard have already declined substantially in 1974 as demand weakened.

Kirby management does not expect any significant improvement in income in 1975 over 1974 levels unless the national economy improves, interest rates decline and mortgage money becomes available resulting in increased housing starts and general improvement in the building industry.

Capital expenditures for the first half of 1974 totaled $12.2 million. An additional $10.9 million is expected to be expended in the last half of 1974.

Recent Developments

In the Spring of 1973, construction was started on a new plywood plant at Bon Wier, Texas. Although construction was hampered by heavy rains in 1973, start-up is anticipated in late 1974 as originally projected. Kirby's annual plywood capacity of 117 million square feet (3/8 inch equivalent) will be more than doubled when this new 160 million square feet capacity plant is completed. Wood raw materials for the plant will come from Kirby's timber resources.

In mid-1973, plans were announced for major diversification by Kirby into another field of wood products when Kirby purchased Evans Products Company's Silsbee, Texas particleboard plant which had been shut down since March, 1973. Demolition of various obsolete facilities of the plant was completed in 1973, and construction of the new 80 million square feet (3/4 inch equivalent) a year particleboard plant has been started with initial operations

scheduled for late 1974. Approximately 60% of the wood required for particleboard production will come from Kirby's plants, while the remainder will be secured from outside sources.

Differing Senate and House Bills establishing a 85,000 to 100,000 acre Big Thicket National Biological Reserve have passed their respective houses and are pending before a House-Senate Conference Committee. The establishment of such a reserve will probably result in the loss by condemnation of 12,000 to 15,000 acres of Kirby forest land. If passed it may be several years before Kirby receives compensation, and depending on the final form of the Act, Kirby may be prevented from harvesting the timber during this time. Payment of capital gains tax will be avoided if replacement lands can be acquired with condemnation funds within the allowed statutory period.

For several years Kirby has participated in discussions with a number of forest product companies seeking a joint venture in various forms with Kirby involving the conversion of Kirby pulpwood and wood chips into paper products. Kirby has not reached a decision with respect to the basic question of the desirability of Kirby's participation in a joint venture paper products conversion plant.

Kirby has a number of new long-term capital expansion plans under various stages of consideration. These plans include both new facilities to expand present product lines and ventures into new product lines for its basic timber resource. None of these plans has received final approval of the Kirby management or its Board of Directors, and it is possible that some or all of these expansion plans will never be carried through to completion. However, if all of these plans were carried out in the next five years, Kirby would require new capital investment totalling approximately $50 million during the period and would ex-

pect to generate additional revenues and income from such investment.

Marketing

Kirby is moving away from the sale of its products through brokers and middlemen and now utilizes a single "in-house" group to market about 80% of its lumber and 100% of its plywood. This group monitors markets and prices and varies the production mix of lumber and plywood accordingly.

Employees

During 1973 Kirby employed an average of 971 employees. The Silsbee plant complex is unionized, but the dimension plant at Cleveland, Texas is not. Following a two-week strike at the Silsbee complex in 1973, a three-year contract was entered with the International Woodworkers of America. The contract, which expires July 28, 1976, provides for yearly wage increases.

When completed, the plywood plant at Bon Wier and the particleboard plant at Silsbee will employ approximately 400 employees.

Kirby is a participant in the Santa Fe Railway System Retirement Plan under which salaried employees are eligible for pension benefits. Kirby also has a noncontributory retirement plan covering substantially all hourly employees. See Note (b) of "Notes to Statement of Income and Retained Income".

In 1973, Kirby adopted an incentive compensation plan for certain key management employees. Under this plan, additional compensation is available to the extent of ten percent of the excess of income for the year, as defined, over the amount budgeted at the beginning of the year. The

cost of the plan in 1973 was $268,000. See Note (b) of "Notes to Statement of Income and Retained Income".

Also selected management employees have been granted options at no expense to Kirby to purchase Santa Fe Common Stock under Santa Fe's 1968 qualified stock option plan.

Since the enactment of the Occupational Safety and Health Act of 1970, Kirby has spent substantial amounts of money to conform its operations to the Act's standards. Presently, there is a two year moratorium on some of the noise standards applicable to the forest products industry because of the unavailability of appropriate technology.

Competition and Other Factors

Kirby encounters strong competition in the production and sale of lumber, plywood and forest products from producers of similar commodities as well as from producers of building material substitutes.

During 1973 and the first six months of 1974 when many petroleum based products were in short supply, Kirby was able to secure sufficient quantities of such products, including phenolic resin for bonding plywood, necessary to carry out its operations. It also has an assured supply of alternate fuel for its plants' operations since wood residue may be burned. The energy shortage could contribute to reduced housing starts in the future which would, in turn, reduce demand for Kirby's products and lead to increased manufacturing costs primarily in the manufacture of plywood and particleboard where petroleum based resins (the prices of which increased 234% since January 1, 1973) already account for approximately 65% of the plywood material and supply costs, exclusive of raw lumber costs.

In the area of forest and land management, Kirby is faced with the uncertainties created by state and federal

regulation. Kirby has felt pressure from environmentalists since the mid- and late- 1960's to replace clear cutting with selective cutting, and to refrain from harvesting timber along creeks, highways and housing. Under current regulations the States determine when conditions are proper for culturally prescribed burning, limiting the total to only 50-70 days per year.

Litigation

In 1972 a class action was filed in the United States, District Court, Eastern District of Louisiana, on behalf of building supply dealers against substantially all U.S. and Canadian lumber and plywood manufacturers, including Kirby, and various trade associations. In 1973 four additional class actions were filed on behalf of others engaged in the manufacture, sale or use of plywood products against essentially the same lumber and plywood manufacturers. These cases principally involve the allegation that the defendants engaged in certain acts which operated to restrain trade in violation of the antitrust laws, for which treble damages are sought. Protracted litigation seems likely, but in the opinion of management and counsel such litigation will not have a material adverse effect on the financial position or results of operations of Kirby.

OIL AND GAS OPERATIONS

General

Kirby owns various oil, gas and mineral interests on its properties. Income is generated through lease and option payments and royalties from these interests. Kirby does not operate any of the leases. Over the last five years the number of wells abandoned has exceeded the number of new producing wells, so that there has been a steady decline of producing wells from 70 in 1969 to 50 in 1973.

Operations in 1973 and 1974

Nine new wells were drilled on Kirby's mineral holdings in 1973 and two were completed as producers. Also during 1973, twenty-four new oil and gas lease agreements covering 25,934 mineral acres were consummated, along with four option agreements on an additional 7,870 acres. For the year Kirby received $1.3 million in oil and gas related revenues.

During the first six months of 1974, Kirby received $.5 million in oil and gas related revenues, as compared to $.8 million during the same period in 1973.

SALE OF TIMBER AND LAND

From time to time Kirby sells timber to lumber, plywood or paper manufacturers when timber available for harvesting exceeds the amount needed in its own manufacturing operations. Kirby occasionally sells land which is no longer needed for operations.

During the first half of 1974, Kirby sold 16.7 million board feet of standing timber, representing the difference between the 1974 sustained-yield budget and Kirby's plant requirements for the year. Little, if any, standing timber will be sold in 1975 due to the timber needs of the Bon Weir plywood plant which is expected to be completed late this year.

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PROPERTIES

Forest Lands

As of January 1, 1974 Kirby owned 557,222.6 acres of forest lands located in eleven counties and two parishes along the eastern border of Texas and the southwestern border of Louisiana, respectively, as listed below.

Location	Estimated* Acreage as of January 1, 1974
San Jacinto County, Texas	1,245.0
Liberty County, Texas	48,259.1
Polk County, Texas	40,535.7
Hardin County, Texas	129,458.0
Jefferson County, Texas	190.8
Tyler County, Texas	91,550.5
Shelby County, Texas	76.0
San Augustine County, Texas	21,782.2
Sabine County, Texas	10,602.5
Jasper County, Texas	53,334.4
Newton County, Texas	124,513.8
Total Texas Forest Lands	521,548.0
Vernon Parish, Louisiana	24,908.0
Beauregard Parish, Louisiana	10,766.6
Total Louisiana Forest Lands	35,674.6
Grand Total Forest Lands	557,222.6

* This estimate was prepared in conjunction with the appraisal discussed under "Appraisal of Land, Timber, Buildings and Machinery."

The timber on these lands is in varying combinations of southern pine, loblolly pine and hardwood. Kirby has a total of 63,989 acres in pine plantations made up of 36,830 acres in southern pine plantations, 16,507 acres in loblolly pine plantations, and 10,652 acres in mixed pine plantations. The first plantations were planted in 1940. Since 1969-1970, 21,637 acres have been planted, which is 34% of the total plantation acreage. Of the total plantation acreage of 64,000, 33,000 acres of timber are of marketable age.

None of Kirby's forests are overly mature. The forests were cleared of the oldest trees (100-120 years) over twenty years ago. Presently they are being managed to yield trees no more than 60-70 years old and will eventually contain trees no more than 40-50 years old.

Kirby carries no fire or casualty insurance on its forests. Since mid-1960, Kirby has attempted to secure title insurance for the amount of the purchase price when it acquires new lands. Lands acquired prior to that time are not covered by title insurance. In 1972 about 4,000 acres of Kirby forest were severely damaged by hailstorms, but the majority of the timber was cut before it died.

Kirby has identified 40 of its tracts, a total of 26,933.5 acres, all or part of which are considered to have potential use as recreational, residential, or industrial lands. When conducting their appraisal, Appraisal Associates classified 10,674.4 of those acres as "Realty Acres" having a higher and better use than the production of forest products. See "Appraisal of Land, Timber, Buildings and Machinery."

Plant Buildings, Machinery and Equipment

Silsbee, Texas

The traditional business of Kirby has been to convert its timber resources to lumber and plywood. The main

complex for this conversion is located on 247 acres of land at Silsbee, Texas, and consists of steam and power generating facilities, a sawmill and plywood plant.

The facility used to produce lumber is the sawmill, which was constructed in 1955. The sawmill facility consists of log receiving and storage pond facilities, log debarking facilities, the sawmill proper, chipping facilities, drying facilities, remanufacturing facilities and planing, finish and storage facilities. Ancillary facilities include a shop, warehouse, office building, a wood preserving plant, and a mill which produces "2 by 4s" from the plywood lathe cores.

The present annual capacity of the sawmill is 60 million board feet (MMBF) with 58.6 MMBF the actual production in 1973. The sawmill contains Kirby's oldest equipment. Breakdowns in the plant are not uncommon. The sawmill was originally built to produce lumber in specialty sizes and sort it into numerous qualities. However, Kirby has moved to the higher volume, faster production of dimension lumber in a relatively few sizes. One result of this change is that the large storage sheds which were built to hold hundreds of different items in finished inventory now have a considerable amount of unused space.

It is anticipated that sawmill capacity for 1975 will be substantially reduced as a result of plant modifications. In order to obtain satisfactory profit margins for the Silsbee complex, substantial modifications estimated to cost in excess of $6.0 million will be required in the near future.

The Company's plywood plant at Silsbee was completed in 1964 and expanded in 1971 and 1972. The plant contains two lathes, three veneer dryers, two presses, grading and saw lines and a loading area. The capacity of the plywood plant is 117 million square feet (MMSF) (3/8" equivalent), with 105 MMSF the actual production in 1973.

A new particleboard plant is being constructed on 10 acres where Evans Products Company formerly operated a plant. Three buildings of the old plant remain, while most of the old machinery has been scrapped. Parts of the buildings have been torn down and new machinery is being installed. The plant should be in operation in late 1974. See "Recent Developments."

Cleveland, Texas

Kirby has a small facility at Cleveland, Texas located on 7.5 acres of Railway land at which special order items, such as chair seats, are made from plywood and particleboard. The physical plant consists of production equipment and a metal building with an office section, and various storage buildings.

Bon Wier, Texas

In the Spring of 1973, construction was started on a new plywood plant on a 40-acre site in Bon Wier, Texas. The project was approximately 75% complete as of June 30, 1974, and initial operations are scheduled for late 1974. The plant has been designed to produce 160 MMSF (3/8" equivalent) annually following a normal start-up period of approximately one year.

Operating Equipment

Kirby owns automobiles, trucks, intra-plant railroad equipment, office equipment and furniture, firefighting equipment and other operating equipment in sufficient quantities to support its operations.

Oil and Gas Properties

Kirby's mineral interests are located within 314,138 net mineral acres in 19 counties and parishes in Texas and

Louisiana. Most of the mineral acreage is located in the Upper Gulf Coast geological province of Southeast Texas and Western Louisiana. Kirby's proved producing oil and gas reserves are 336,578 barrels of crude oil and 2,739,762 MCF of gas as determined by Riggs and Associates in their appraisal. See "Appraisal of Mineral Rights" and Table 2 to Exhibit E.

Miscellaneous Properties

Kirby also operates a trailer park on 54 acres near Beaumont, Texas and similar facilities, primarily for employees, on about 10 acres near Bon Wier, Texas.

CERTAIN TRANSACTIONS WITH SANTA FE INDUSTRIES, INC. AND ITS SUBSIDIARIES

Sales of Kirby Products To The Atchison, Topeka and Santa Fe Railway Company

From time to time, Kirby sells lumber and plywood to Railway. During 1973 sales amounted to $425,000, and for the first six months of 1974 sales amounted to $185,000. All sales are at market prices.

Kirby Shipments on The Atchison, Topeka and Santa Fe Railway Company

Kirby has utilized the transportation services of Railway which is the only railroad serving Silsbee. Kirby receives some saw timber by rail while shipping out some lumber and plywood by rail. All shipments are made at tariff rates. During the twenty-nine months from January 1, 1972 through May 31, 1974, Kirby shipped approximately 9% of its lumber and 65% of its plywood via Railway with most of the balance distributed by Kirby trucks

or customer trucks. Beginning in 1973, Railway traffic attributable to Kirby operations has been sharply reduced primarily due to a shift in inbound saw timber deliveries from rail to truck. The following table shows carloads shipped by and revenues paid to Railway by Kirby for the years 1969 through 1973 and the first five months of 1974.

Year	Carloads	Railway Revenues
1969	5851	$569,885
1970	5669	584,078
1971	4799	512,058
1972	4803	585,562
1973	2876	381,274
First 5 months of 1974	1106	191,848

Management of Southwestern Improvement Co.'s Forest Lands

Since January 1970, Kirby has managed the surface estate of approximately 75,000 acres of forest lands owned by Southwestern Improvement Company ("Southwestern"), a wholly owned subsidiary of Resources. Kirby manages the lands in the same manner it manages its own. For managing Southwestern's lands, Kirby receives an annual service charge which is based on the average per acre cost of managing all timber lands owned or managed by Kirby for the preceding year. Additionally, Kirby is entitled to purchase at fair market prices the entire amount of timber ready for harvesting. During 1973 Kirby received $98,799.96 in service charges and purchased $197,643.16 of pine saw timber from Southwestern. During the first six months of 1974, Kirby received $62,819.50 in service charges and purchased $4,209.84 of pine saw timber.

Acquisition of Walker-Kurth Lumber Company by Santa Fe Industries, Inc.

In 1973, Kirby's President and representatives of the stockholders of Walker-Kurth Lumber Company ("Walker-Kurth") had several discussions concerning the sale of the stock of Walker-Kurth to Kirby. The Walker-Kurth stockholders insisted on receiving, in exchange for their stock, stock of a company listed and traded on a national securities exchange and on a tax-free exchange; however, Kirby was unable to comply with this condition. As a result, the stockholders of Walker-Kurth, upon the suggestion of Kirby's President, entered into discussions with Santa Fe which resulted in the acquisition of all of the stock of Walker-Kurth by Santa Fe in late 1973.

Management Consulting Agreement with Walker-Kurth Lumber Company and Sales by Kirby to Walker-Kurth Lumber Company

As of April 1, 1974, Kirby and Walker-Kurth entered a management consulting agreement under which Walker-Kurth pays $24,000 annually to Kirby in return for certain services which includes, among other things, general management consultation, accounting and financial advisory services, forecasting and profit planning techniques, and personnel policies and practices. During the first six months of 1974 Kirby has received $6,000.00 in fees under the arrangement.

Kirby also sells lumber and plywood to Walker-Kurth at current market prices. In 1973 Kirby's sales totalled $91,884.68 while in the first six months of 1974 sales totalled $80,978.74.

Management Fee Arrangement with Santa Fe Industries, Inc.

Subsidiaries in which Santa Fe has a greater than 50% ownership such as Kirby, pay an annual management fee to Santa Fe. The fee paid by each subsidiary is a portion of Santa Fe's general and administrative expenses determined by a formula based on the subsidiary's annual sales and income before federal income tax and Santa Fe's investment at equity in the subsidiary. In 1973 the fee paid by Kirby was $94,000, an increase from $69,000 in 1972. Kirby's 1974 fee is estimated to be $96,000.

Construction Management Contract with Robert E. McKee, Inc.

Robert E. McKee, Inc. ("McKee"), a wholly owned subsidiary of Santa Fe has been hired to furnish construction management and contract administration services in conjunction with the construction of the new plywood plant at Bon Wier, Texas. McKee is a general construction contractor operating principally in the South, Southwest and West and is also active in the field of construction management. As of June 30, 1974, Kirby has paid McKee $34,387.00 for its services since construction was first started in the Spring of 1973.

Oil and Gas Lease with Coline Oil Corporation

Coline Oil Corporation ("Coline"), a wholly owned subsidiary of Resources, operates Kirby Lease No. 300. Kirby has a 12.5% royalty interest in the lease from which it received $1,750 from Coline during the first six months of 1974.

Santa Fe Industries, Inc.
Consolidated Federal Income Tax Return

The taxable income of Kirby is included in a consolidated federal income tax return filed by Santa Fe, the indirect owner of the outstanding Capital Stock of Kirby. Under an income tax allocation agreement between Santa Fe and the members of the consolidated group, Kirby makes payments of federal income tax to its parent on the basis of the tax that would be payable if a separate return were filed by Kirby. Kirby computes its separate return federal income tax liability using an alternative tax computation method giving effect to special tax provisions applicable to companies engaged in timber operations. See Note (a) of the "Notes to Statement of Income and Retained Income."

Interim Credit Agreement with Santa Fe Industries, Inc.

Under an interim credit agreement with Santa Fe, Kirby may borrow up to $15,000,000 to provide interim construction financing for the new plywood facility and particleboard facilities. As of June 30, 1974 $1,600,000 had been borrowed. It is intended that borrowings under this agreement are to be repaid with the proceeds of a term loan from a non-affiliated lender to be arranged upon completion of construction of the new facilities. Otherwise, the aggregate principal amount is payable on March 15, 1979. Interest is charged at ½ of 1% over the prime rate. See Note 3 of the "Notes to Financial Statements."

Land Exchange with Subsidiary of Santa Fe

In 1972, in order to take advantage of the nonrecognition of gain provisions of the Internal Revenue Code, 439.07 acres of Kirby real estate which had developed

a higher economic use than timber lands were exchanged, based on fair market values, for 3,797.59 acres of timber land selected by Kirby and acquired for that purpose by a wholly owned subsidiary of Santa Fe. The value of the Kirby land exchanged, which approximated $828,000, was determined by independent appraisals. The exchange was a tax-free exchange for Federal income tax purposes and no gain or loss was recorded on the books of Kirby.

DESCRIPTION OF KIRBY STOCK

The Certificate of Incorporation, as amended, of Kirby provides for 750,000 shares of authorized Capital Stock with a par value of $1. Prior to the merger, 500,000 shares were issued and outstanding, and upon effectiveness of the merger 1,000 shares were outstanding. Each share of Capital Stock entitles the holder to one vote thereof for the election of directors and all other matters submitted to the vote of stockholders. The Capital Stock has noncumulative voting rights. On liquidation, dissolution, or winding up, stockholders are entitled to share ratably in all assets available for distribution. Stockholders have no preemptive rights.

MISCELLANEOUS

Information contained in this Information Statement has been furnished by Santa Fe, Resources, and Kirby.

The cost of preparing and mailing this Information Statement will be borne by Resources.

Exhibit A to Davis Affidavit.

KIRBY LUMBER CORPORATION
INDEX TO FINANCIAL STATEMENTS

Exhibit A to Davis Affidavit.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of
Kirby Lumber Corporation

In our opinion, the accompanying balance sheet and the related statement of income and retained income, appearing elsewhere in this Information Statement, and the statement of changes in financial position present fairly the financial position of Kirby Lumber Corporation at December 31, 1973 and the results of its operations and the changes in its financial position for the five years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Houston, Texas
February 3, 1974

Exhibit A to Davis Affidavit.

KIRBY LUMBER CORPORATION

BALANCE SHEET

	December 31, 1973	June 30, 1974 (unaudited)
	(In Thousands)	
ASSETS		
CURRENT ASSETS		
Cash	$ 52	$(163)
Temporary investments (at cost which approximates market)	7 374	200
Accounts and notes receivable	1 645	1 920
Inventories (Note 1)	1 470	1 652
Prepaid and deferred charges	210	273
Total current assets	10 751	3 882
NOTES RECEIVABLE COLLECTIBLE AFTER ONE YEAR	25	—
PROPERTIES, at cost (Note 1)		
Timber and land	7 455	8 628
Mills, millsite and equipment	32 615	33 103
Total properties	40 070	41 731
Less—Accumulated depreciation	17 146	18 118
	22 924	23 613
Construction in progress	8 663	19 166
Net properties	31 587	42 779
TOTAL	$ 42 363	$ 46 661

Exhibit A to Davis Affidavit.

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 1973	June 30, 1974 (unaudited)
CURRENT LIABILITIES		
Accounts and wages payable	$ 2 283	$ 1 851
Accrued liabilities	1 660	1 772
Federal income tax payable (Note a)	61	548
Note payable due within one year (Note 3)	1 000	—
Total current liabilities	5 004	4 171
NOTES PAYABLE (Note 3)	2 250	3 850
DEFERRED FEDERAL INCOME TAX (Note 1)	1 139	1 139
UNFUNDED PENSION COSTS (Note b)	372	474
STOCKHOLDERS' EQUITY		
Capital stock $1 par value, 750,000 shares authorized, 500,000 shares issued and outstanding (Note 2)	500	500
Paid-in capital	5 099	5 099
Retained income	27 999	31 428
Total stockholders' equity	33 598	37 027
TOTAL	$ 42 363	$ 46 661

Exhibit A to Davis Affidavit.

KIRBY LUMBER CORPORATION
STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31					Six Months Ended June 30
	1969	1970	1971	1972 (In Thousands)	1973	1974 (unaudited)
WORKING CAPITAL SOURCES						
Net income	$ 4 724	$ 2 049	$ 2 805	$ 4 130	$ 6 002	$ 3 429
Depreciation and depletion	1 372	1 565	1 858	2 105	2 012	1 034
Unfunded pension costs	—	39	116	42	176	102
Deferred federal income tax	301	—	—	36	68	—
Working capital provided from operations	6 397	3 653	4 779	6 313	8 258	4 565
Notes payable (Note 3)	—	—	—	—	3 250	1 600
Other, net	(98)	(56)	113	81	134	25
Total working capital sources	6 299	3 597	4 892	6 394	11 642	6 190
WORKING CAPITAL USES						
Capital expenditures	1 247	4 960	2 874	3 780	11 028	12 226
Portion of note payable becoming due within one year	—	—	—	—	1 000	—
Dividends paid	1 500	1 500	1 500	1 500	1 500	--
Total working capital uses	2 747	6 460	4 374	5 280	13 528	12 226

Exhibit A to Davis Affidavit.

	Year Ended December 31					Six Months Ended June 30
	1969	1970	1971	1972 (In Thousands)	1973	1974 (unaudited)
INCREASE (DECREASE) IN WORKING CAPITAL	$ 3 552	$(2 863)	$ 518	$ 1 114	$(1 886)	$(6 036)
CHANGES IN ELEMENTS OF WORKING CAPITAL						
Cash, temporary investments and demand notes from affiliates	$ 3 320	$(3 051)	$ 514	$ 1 287	$ 719	$(7 389)
Receivables	23	(58)	421	326	(122)	275
Inventories	220	188	(162)	(246)	441	182
Prepaid and deferred charges	70	(37)	52	133	(90)	63
Note payable due within one year	—	—	—	—	(1 000)	1 000
Accounts and wages payable	(115)	(132)	73	(365)	(1 253)	432
Accrued liabilities	(97)	182	(334)	(13)	(573)	(112)
Federal income tax payable	131	45	(46)	(8)	(8)	(487)
INCREASE (DECREASE) IN WORKING CAPITAL	$ 3 552	$(2 863)	$ 518	$ 1 114	$(1 886)	$(6 036)

(See notes to financial statements)

KIRBY LUMBER CORPORATION
NOTES TO FINANCIAL STATEMENTS

(All information relating to the six months ended June 30, 1974 is unaudited. Alphabetical note references refer to notes to Statement of Income and Retained Income on pages 28a-32a.)

Note 1—Accounting Policies

Inventories are stated at the lower of cost (average or first-in, first-out) or market.

Timber and land are carried at cost which includes expenditures incurred in reforestation activities less timber depletion computed by the unit of production method. All other properties are depreciated on a straight-line basis over their estimated useful lives. Interest on debt which finances the construction of plant facilities is capitalized during the construction period as part of the cost of such facilities.

Provisions for federal income tax recognize the tax effects of all transactions entering into the determination of income for financial reporting purposes irrespective of when such transactions are reported for federal income tax purposes. Accordingly, income is charged for tax currently payable as well as a provision for deferred taxes representing tax reductions resulting from timing differences (consisting principally of additional tax deductions arising from the use of accelerated and guideline depreciation for tax purposes only). Deferred federal income tax reflected on the balance sheet does not represent a liability to the federal government. If timing differences in future years result in an increase in tax currently payable for such years, such increase will not be charged to income but will be charged to deferred federal income tax or, if

applicable, will be reimbursed under the tax allocation agreement (see Note a).

Note 2—Stock Ownership

At both December 31, 1973 and June 30, 1974, approximately 94.9% of the outstanding capital stock of Kirby was owned by Santa Fe Natural Resources, Inc. (a wholly owned subsidiary of Santa Fe Industries, Inc.). On July 31, 1974, Kirby became a wholly owned subsidiary of Santa Fe Natural Resources, Inc., pursuant to the terms of a statutory merger described in "Summary of Merger".

Note 3—Notes Payable

In 1973 Kirby incurred a note payable (original principal amount of \$3,250,000) in connection with the purchase of property for a new particleboard plant. This note is unsecured and bears interest at ¾ of 1% above the prime rate. \$1,000,000 was paid on June 8, 1974, and the remaining \$2,250,000 is payable on June 8, 1978.

Under an interim credit agreement with Santa Fe Industries, Inc. (see Note 2 above), Kirby may borrow up to \$15,000,000 to provide interim construction financing for new plywood and particleboard facilities. As of June 30, 1974 \$1,600,000 had been borrowed. It is intended that borrowings under this agreement are to be repaid with the proceeds of a term loan from a non-affiliated lender to be arranged upon completion of construction of the new facilities. Otherwise, the aggregate principal amount is payable on March 15, 1979. Interest is charged at ½ of 1% over the prime rate.

Interest on both notes payable is being capitalized during the construction of the related facilities. Such interest capitalized aggregated \$185,000 at December 31, 1973 and \$359,000 at June 30, 1974.

Note 4—Commitments and Contingencies

It is estimated that capital expenditures in 1974 will aggregate approximately $23.1 million.

In 1972 a class action was filed in the United States District Court, Eastern District of Louisiana, on behalf of building supply dealers against substantially all U. S. and Canadian lumber and plywood manufacturers, including Kirby, and various trade associations. In 1973 four additional class actions were filed on behalf of others engaged in the manufacture, sale or use of plywood products against essentially the same lumber and plywood manufacturers. These cases principally involve the allegation that the defendants engaged in certain acts which operated to restrain trade in violation of the antitrust laws, for which treble damages are sought. Protracted litigation seems likely, but in the opinion of management and counsel such litigation will not have a material adverse effect on the financial position or results of operations of Kirby.

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EXHIBIT A

§ 253. Merger of parent corporation and subsidiary or subsidiaries

(a) In any case in which at least 90 percent of the outstanding shares of each class of the stock of a corporation or corporations is owned by another corporation and one of such corporations is a corporation of this State and the other or others are corporations of this State or of any other state or states or of the District of Columbia and the laws of such other state or states or of the District permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction, the corporation having such stock ownership may either merge such other corporation or corporations into itself and assume all of its or their obligations, or merge itself, or itself and one or more of such other corporations, into one of such other corporations by executing, acknowledging and filing, in accordance with section 103 of this title, a certificate of such ownership and merger setting forth a copy of the resolution of its board of directors to so merge and the date of the adoption thereof; provided, however, that in case the parent corporation shall not own all the outstanding stock of all the subsidiary corporations, parties to a merger as aforesaid, the resolution of the board of directors of the parent corporation shall state the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation. If the parent corporation be not the surviving corporation, the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor, and

the certificate of ownership and merger shall state that the proposed merger has been approved by a majority of the outstanding stock of the parent corporation entitled to vote thereon at a meeting thereof duly called and held after 20 days' notice of the purpose of the meeting mailed to each such stockholder at his address as it appears on the records of the corporation. A certified copy of the certificate shall be recorded in the office of the Recorder of the County in this State in which the registered office of each constituent corporation which is a corporation of this State is located. If the surviving corporation exists under the laws of the District of Columbia or any state other than this State, the provisions of section 252(d) of this title shall also apply to a merger under this section.

(b) If the surviving corporation is a Delaware corporation, it may change its corporate name by the inclusion of a provision to that effect in the resolution of merger adopted by the directors of the parent corporation and set forth in the certificate of ownership and merger, and upon the effective date of the merger, the name of the corporation shall be so changed.

(c) The provisions of Section 251(d) of this title shall apply to a merger under this section, and the provisions of Section 251(e) shall apply to a merger under this section in which the surviving corporation is the subsidiary corporation and is a corporation of this State. Any merger which effects any changes other than those authorized by this section or made applicable by this subsection shall be accomplished under the provisions of Section 251 or Section 252 of this title. The provisions of Section 262 of this title shall not apply to any merger effected under this section, except as provided in subsection (d) of this section.

(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the surviving corporation shall, within 10 days after the effective date of the merger, notify each stockholder of such Delaware corporation that the merger has become effective. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any such stockholder may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation payment of the value of his stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If during a period of 30 days after such period of 20 days the surviving corporation and any such objecting stockholder fail to agree as to the value of such stock, any such stockholder or the corporation may file a petition in the Court of Chancery as provided in subsection (c) of section 262 of this title and thereupon the parties shall have the rights and duties and follow the procedure set forth in subsections (d) to (j) inclusive of section 262.

(e) A merger may be effected under this section although one or more of the corporations parties to the merger is a corporation organized under the laws of a jurisdiction other than one of the United States; provided that the laws of such jurisdiction permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction; and provided further that the surviving or resulting corporation shall be a corporation of this State.

§ 262. Payment for stock or membership of person objecting to merger or consolidation

(a) When used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words "stock" and "share" mean and include what is

ordinarily meant by those words and also membership or membership interest of a member of a non-stock corporation.

(b) The corporation surviving or resulting from any merger or consolidation shall within 10 days after the effective date of the merger or consolidation, notify each stockholder of any corporation of this State so merging or consolidating who objected thereto in writing and whose shares, either were not entitled to vote or were not voted in favor of the merger or consolidation, and who filed such written objection with the corporation before the taking of the vote on the merger or consolidation, that the merger or consolidation has become effective. Such notice shall likewise be given to each stockholder whose corporation approved the merger or consolidation pursuant to section 228 of this title without a meeting of its stockholders and who either did not, or had no right to, consent in writing to such merger or consolidation. If any such stockholder shall within 20 days after the date of mailing of the notice demand in writing, from the corporation surviving or resulting from the merger or consolidation, payment of the value of his stock, the surviving or resulting corporation shall, within 30 days after the expiration of the period of 20 days, pay to him the value of his stock on the effective date of the merger or consolidation, exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation.

(c) If during a period of 30 days following the period of 20 days provided for in subsection (b) of this section, the corporation and any such stockholder fail to agree upon the value of such stock, any such stockholder, or the corporation surviving or resulting from the merger or consolidation may, by petition filed in the Court of Chancery within four months after the expiration of the period of 30 days, demand a determination of the value of the stock

of all such stockholders by an appraiser to be appointed by the Court.

(d) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the corporation, which shall within ten days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the corporation. If the petition shall be filed by the corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the corporation and to the stockholders shown upon the list at the addresses therein stated, and notice shall also be given by publishing a notice at least once at least one week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware. The Court may direct such additional publication of notice as it deems advisable. The forms of the notices by mail and by publication shall be approved by the Court.

(e) After the hearing on such petition the Court shall determine the stockholders who have complied with the provisions of this section and become entitled to the valuation of and payment for their shares, and shall appoint an appraiser to determine such value. Such appraiser may examine any of the books and records of the corporation or corporations the stock of which he is charged with the duty of valuing, and he shall make a determination of the value of the shares upon such investigation as to him seems proper. The appraiser shall also afford a reasonable opportunity to the parties interested to submit to him per-

tinent evidence on the value of the shares. The appraiser, also, shall have such powers and authority as may be conferred upon masters by the rules of the Court of Chancery or by the order of his appointment.

(f) The appraiser shall determine the value of the stock of the stockholders adjudged by the Court of Chancery to be entitled to payment therefor and shall file his report respecting such value in the office of the Register in Chancery and notice of the filing of such report shall be given by the Register in Chancery to the parties in interest. Such report shall be subject to exceptions to be heard before the Court both upon the law and facts. The Court shall by its decree determine the value of the stock of the stockholders entitled to payment therefor and shall direct the payment of such value, together with interest, if any, as hereinafter provided, to the stockholders entitled thereto by the surviving or resulting corporation upon the transfer to it of the certificates representing such stock, which decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other state.

(g) At the time of appointing the appraiser or at any time thereafter the Court may require the stockholders who demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, and if any stockholder fails to comply with such direction the Court may dismiss the proceedings as to such stockholder.

(h) The cost of any such appraisal, including a reasonable fee to and the reasonable expenses of the appraiser, but exclusive of fees of counsel or of experts retained by any party, may on application of any party in interest

be determined by the Court and taxed upon the parties to such appraisal or any of them as appears to be equitable, except that the cost of giving the notice by publication and by registered mail hereinabove provided for shall be paid by the corporation. The Court may, on application of any party in interest, determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto.

(i) Any stockholder who has demanded payment of his stock as herein provided shall not thereafter be entitled to vote such stock for any purpose or be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation) unless the appointment of an appraiser shall not be applied for within the time herein provided, or the proceeding be dismissed as to such stockholder, or unless such stockholder shall with the written approval of the corporation deliver to the corporation a written withdrawal of his objections to and an acceptance of the merger or consolidation, in any of which cases the right of such stockholder to payment for his stock shall cease.

(j) The shares of the surviving or resulting corporation into which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

(k) This section shall not apply to the shares of any class or series of a class of stock, which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation is to be acted on, were either (1) listed on a national securities

exchange, or (2) held of record by more than 2,000 stockholders, unless the certificate of incorporation of the corporation issuing such stock shall otherwise provide; nor shall this section apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of Section 251 of this title. This subsection shall not be applicable to shares of any class or series of a class of stock of a constituent corporation if under the terms of a merger or consolidation pursuant to Section 251 or Section 252 of this title the holders thereof are required to accept for such stock anything except (a) shares of stock or shares of stock and cash in lieu of fractional shares of the corporation surviving or resulting from such merger or consolidation; or (b) shares of stock or shares of stock and cash in lieu of fractional shares of any other corporation, which at the effective date of the merger or consolidation will be either (1) listed on a national securities exchange or (2) held of record by more than 2,000 stockholders; or (c) a combination of shares of stock or shares of stock and cash in lieu of fractional shares as set forth in (a) and (b) of this subsection.

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EXHIBIT B

CERTIFICATE OF OWNERSHIP AND MERGER
FOREST PRODUCTS, INC.
INTO
KIRBY LUMBER CORPORATION

(Pursuant to Section 253 of the General Corporation Law of Delaware)

Forest Products, Inc. a corporation organized and existing under the laws of Delaware (the "Corporation") does hereby certify:

FIRST: That the Corporation was incorporated on the 11th day of July, 1974, pursuant to the General Corporation Law of the State of Delaware.

SECOND: That the Corporation owns 474,675½ shares of the 500,000 outstanding shares of Capital Stock of Kirby Lumber Corporation, a Delaware Corporation, which shares constitute at least 90% of the only class of stock of Kirby Lumber Corporation as to which there are any shares outstanding.

THIRD: That the merger of the Corporation into Kirby Lumber Corporation, pursuant to the provisions of Section 253 of the General Corporation Law of Delaware, has been duly approved by the Board of Directors of the Corporation by adoption on July 30, 1974 of the following resolutions, which have not been amended or rescinded and are now in full force and effect:

RESOLVED:

1. This Corporation be merged with and into Kirby Lumber Corporation, (herein sometimes referred to

as the "Surviving Corporation"), pursuant to Section 253 of the General Corporation Law of the State of Delaware, upon the following terms and conditions:

(a) The merger will become effective upon the execution, acknowledgment and filing, in accordance with Section 103 of the General Corporation Law of Delaware, of the Certificate of Ownership and Merger required by the provisions of Section 253 of that Law.

(b) Upon the merger becoming effective, the Surviving Corporation will acquire all of the assets and assume all of the obligations of this Corporation.

(c) Upon the merger becoming effective (i) each of the 1,000 shares of Capital Stock of this Corporation outstanding at the time of the merger will be converted, by virtue of the merger and without any action on the part of the holders thereof, into one fully paid and non-assessable share of Capital Stock of the Surviving Corporation; and (ii) each share of Capital Stock of Kirby Lumber Corporation outstanding at the time of the merger will be cancelled and cease to exist, and each such share not owned by this Corporation will, by virtue of the merger and without any action on the part of the owner thereof, represent only a right to receive in exchange therefor, forthwith, the amount of One Hundred Fifty ($150) Dollars per share in cash, and the holders of such shares shall have no further rights with respect to such shares except the right to receive such amount in cash upon surrender of their certificates for such shares to the Paying Agent designated hereinbelow; and (iii) each share of Capital Stock of Kirby Lumber Corporation issued at the time of the merger and owned by Kirby Lum-

ber Corporation as Treasury shares will be cancelled and cease to exist.

(d) The Certificate of Incorporation and By-Laws of Kirby Lumber Corporation shall at and after the merger becomes effective be the Certificate of Incorporation and By-Laws of the Surviving Corporation, until amended as provided by law.

(e) The identity, existence, purposes, powers, objects, franchises, privileges, rights and immunities of Kirby Lumber Corporation shall continue in effect and unimpaired by the merger, and the corporate franchises, existence and rights of this Corporation shall be merged into Kirby Lumber Corporation, which, as the Surviving Corporation, shall possess all the rights, privileges, powers, immunities, purposes and franchises, both public and private, of this Corporation and shall be liable for and hereby assumes all of the obligations and liabilities of this Corporation then outstanding.

(f) Upon the merger becoming effective, each holder of shares of Capital Stock of Kirby Lumber Corporation outstanding at the time of the merger, other than this Corporation, shall, upon the surrender to the Harris Trust and Savings Bank ("the Paying Agent") of one or more stock certificates, for Capital Stock of Kirby Lumber Corporation, be entitled to receive One Hundred Fifty ($150) Dollars per share, in cash, for each share of Kirby Lumber Corporation represented by the stock certificates surrendered. If a certificate is registered in a name other than that of the person surrendering the certificate or if the check is to be drawn other than in the name of the person surrendering the certificate, then, in either case, (i) the certificate must be properly endorsed for transfer or be ac-

companied by a properly executed stock power, and the signature on the endorsement or the stock power must be guaranteed by a commercial bank or trust company having an office or correspondent in the City of Chicago or by a firm having membership in the New York, Midwest or Pacific Coast Stock Exchanges.

(g) Upon the merger becoming effective, the holder of the certificates representing outstanding shares of Capital Stock of this Corporation may surrender the same to the Surviving Corporation for cancellation and will receive in exchange therefor a certificate or certificates representing the number of shares of the Capital Stock of the Surviving Corporation into which such shares have been converted. Until such surrender and cancellation, each outstanding certificate shall, after the merger becomes effective, be deemed for all purposes to evidence the number of shares of Capital Stock of the Surviving Corporation into which the same shall have been converted by virtue of the merger.

(h) Anything herein or elsewhere to the contrary notwithstanding, this merger may be terminated and abandoned by the Board of Directors of this Corporation at any time prior to the filing of the Certificate of Ownership and Merger with the Secretary of State of Delaware.

(i) Upon the expiration of a period of six years from the effective date of the merger, any unclaimed money due stockholders of the Surviving Corporation as a result of the merger in the hands of the Surviving Corporation shall become the property of the Surviving Corporation.

2. The proper officers of this Corporation be, and they hereby are, authorized and directed, upon the ap-

proval of the merger as set forth in these resolutions by a majority of the holders of the outstanding stock of this Corporation, to make and execute a Certificate of Ownership and Merger as required by Section 253 of the General Corporation Law of Delaware, and to cause the same to be filed with the Secretary of State of Delaware and a certified copy thereof to be recorded in the office of the Recorder of Deeds of New Castle County, Delaware, and to do all acts and things whatsoever, whether within or without the State of Delaware, which may be in anywise necessary or proper to effect the merger; and

3. This Corporation will use its best efforts to cause the Surviving Corporation, within ten days after the filing of the appropriate Certificate of Ownership and Merger, to notify each holder of record of Capital Stock of Kirby Lumber Corporation entitled to such notice that the merger has become effective.

FOURTH: That the aforesaid merger has been approved by written consent, given in accordance with the provisions of Section 228 of the General Corporation Law of Delaware, by the owner of all of the outstanding shares of stock of the Corporation.

IN WITNESS WHEREOF Forest Products, Inc. has caused this Certificate to be signed by T. H. Rodgers, President and attested by D. A. Louden, Assistant Secretary, as of the 31st day of July, 1974.

FOREST PRODUCTS, INC.

By: T. H. Rodgers
President

ATTEST:

D. A. Louden
Assistant Secretary

Exhibit A to Davis Affidavit.

EXHIBIT C

MORGAN STANLEY & CO.
1251 Avenue of the Americas
New York, N.Y. 10020

June 24, 1974

Mr. John C. Davis
Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

Dear Mr. Davis:

You have asked that we furnish an opinion as to the present fair market value of a share of capital stock of Kirby Lumber Corporation ("Kirby" or the "Company"), a subsidiary of Santa Fe Natural Resources, Inc. We understand that 25,324.5 shares or approximately 5.1% of the Company's outstanding capital stock constitutes the minority interest.

In connection with our study of the Company for purposes of making our valuation, we have toured the Company's facilities and have had discussions with management regarding the Company's business. We have been furnished with and have reviewed the Company's audited financial statements for the five years ended December 31, 1973, and the unaudited financial statements for the four-month period ending April 30, 1974. We have reviewed the Company's five-year forecast for the years 1974-1978 and have discussed it and the general future outlook for the Company with its management. Also, we have reviewed the written appraisals of the Company's properties and mineral rights which were separately performed by Appraisal Associates and Riggs and Associates.

Exhibit A to Davis Affidavit.

We have studied the Company's financial position and its operating history and have made comparisons of such information with the financial position and operating histories of other companies in the forest products industry, the securities of which are publicly held and actively traded.

We have, in addition, considered such other matters and made such other studies as we considered necessary or pertinent.

Based on our studies as outlined above, and on the assumptions that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

Very truly yours,

MORGAN STANLEY & CO.

EXHIBIT D

APPRAISAL ASSOCIATES
1016 Baltimore
Kansas City,
Missouri 64105

TELEPHONE 842 8947
TELEPHONE 842 9680

February 19, 1974

Mr. W. J. Swartz
Assistant Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

Re: Kirby Lumber Corporation
Register No. 5140

Dear Mr. Swartz:

I enclose herewith my appraisal of the land, exclusive of minerals and the timber, buildings and machinery belonging to the Kirby Lumber Corporation as of December 31, 1973. In the making of this appraisal I have been assisted by Mr. Ross Ellis, M.A.I., in the valuation of the Realty Land and the Forest Land. I have also consulted with him in connection with the contribution of the timber and in the securing of and the analysis of the indices.

Mr. Thomas J. Newman, R. F., Vice President and Mr. Joe E. Rigsby, Forester, Farm Appraiser of the staff of Resource Management Service, Incorporated, have assisted the appraiser in estimating the contribution of the timber in the Kirby Forest. Mr. Joe E. Rigsby assisted by securing, describing and confirming sales of forest land, including timber. Mr. Newman and his staff supplied the appraiser with the quantities of timber in the Kirby Forest. The stumpage values indicated by the analysis of sales of timber companies, including forests, was discussed at length with Mr. Newman. He also materially assisted in converting costs and quantities into the board foot measure relied upon.

Mr. J. K. Moorehouse of the American Real Estate Corporation in Beaumont, Texas assisted the appraiser by searching the Deed records in the various counties for sales of land and platted a number of sales of large tracts. Mr. Ed Terry, M.A.I., the head of the American Real Estate Corporation, also discussed some sales of land including timber, with the appraiser.

After a careful inspection of the land exclusive of minerals and the timber, buildings and machinery belonging to the Kirby Lumber Corporation on November 27, 28, 29 and 30, December 11, 12, 13, 1973 and in February of 1974, it is the considered judgment of the appraiser that its Market Value as of December 31, 1973, was $320,000,000.00.

The appraiser takes no responsibility for matters which are legal in nature. No responsibility is taken for surveys or data furnished the appraiser by others. The subject property has been appraised as though it were free and clear of all indebtedness and title were vested in the owners as stated. No consideration has been given to minerals, if any. The appraiser has no interest in this or any other property which would influence the values found or the conclusions reached. The value indicated in this report bears no relation to the fee charged.

This appraisal has been made for the exclusive use of Santa Fe Industries in connection with the acquisition of the minority stock interest in the Kirby Lumber Corporation. Its use by other persons or for other purposes is strictly prohibited. The use of part of this report without the consideration of the whole is strictly prohibited and

this report, when used in this manner, is null and void and of no effect.

Neither all nor any part of the contents of this report shall be conveyed to the public through advertising, public relations, news, sales or other media without the written consent and approval of the author, particularly as to valuation conclusions, the identity of the appraiser or firm with which he is connected, or any reference to the American Institute of Real Estate Appraisers or to the M.A.I. designation.

I, the undersigned, do certify that I have personally inspected the property described herein; that I have no past, present or prospective, direct or indirect interest in the said property and my employment in the appraisal is not in any manner contingent upon returning appraisal findings in any specified or implied amount otherwise contingent upon anything other than the delivery of this report. To the best of my knowledge and belief, all of the statements and opinions contained in this report are correct, subject to the limiting conditions herein set forth; also, that this appraisal has been made in conformity with and is subject to the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

Respectfully submitted,

W. D. Davis,
W. D. Davis, M.A.I.,
S.R.E.A., A.R.A., S.R.A.,
A.A.C.I., A.S.A., C.R.E.

EXHIBIT E

RIGGS AND ASSOCIATES
Petroleum Reservoir Consultants
2001 BRYAN TOWER, SUITE 3515
DALLAS, TEXAS 75201 214/741-5971

March 29, 1974

Mr. John C. Davis, Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

Dear Mr. Davis:

By your authorization appraisal has been made of the producing oil and gas royalty interests of Kirby Lumber Corporation ("Kirby") and of their mineral ownership in non-producing properties in Texas and Louisiana. Effective date of the appraisal is January 1, 1974.

Summary

Based upon the appraisal as reported herein, the market value of the proved producing oil and gas reserves and non-producing mineral interests owned by Kirby as of January 1, 1974 is estimated to be:

	Market Value
Producing Oil and Gas Reserves	\$1,856,000
Non-Producing Mineral Interests	6,368,000
TOTAL	\$8,224,000

Discussion of these values follows.

Producing Oil and Gas Reserves

Forecasts of future gross and net oil and gas production, revenue, expenses, and net revenue have been made for

each of the producing royalty interests owned by Kirby as of January 1. 1974. (Working interests, which are minor, are also included.) Individual lease totals are presented in Table 1. An annual cash flow forecast summarized for all properties is presented in Table 2.

The oil and gas prices used in the revenue forecast are those currently in effect for each property; no provision has been made for price escalation. Where applicable, operating expenses and ad valorem taxes are based upon actual costs. Deductions have not been made from net revenue for Federal income taxes or for general overhead expenses on the part of Kirby.

Based upon examination of the cash flow stream (Table 2), it is our opinion that the reasonable market value of these properties is $1,856,000. This represents a rate of return to an investor of 14 percent before Federal income taxes and would be recovered at 8 percent interest in slightly less than 5 years. Because of the rapidly diminishing nature of the cash flow stream, possible future price increases would have only a minimal effect on the cash flow and market value.

Non-producing Mineral Interests

Kirby's mineral interests are located in 19 counties and parishes of Texas and Louisiana as illustrated by the enclosed map and Table 3. Most of the mineral acreage is located in the Upper Gulf Coast geological province of Southeast Texas and Western Louisiana.

The market value of the non-producing mineral interests has been estimated on a tract-by-tract basis. Consideration was given to the proximity of each tract to recent leasing activity, recent exploratory drilling, and current producing fields. As a further aid in establishing these values, economic models were constructed of hypothetical situations of leasing, drilling, and producing-to-depletion

over a representative selection of prospects in the Upper Gulf Coast geological province. The results of this tract-by-tract evaluation are summarized, by counties, in Table 3 and total to a value of $6,368,000. Expressed on a unit basis, this represents a value of $20.27 per net mineral acre. Additional verification of market value can be obtained from examination of the historical revenues derived by Kirby from lease bonuses and rentals for non-producing leases. Bonus and rental income to Kirby for the past ten years has been:

Year	Bonuses and Rentals
1964	$272,000
1965	383,000
1966	254,000
1967	221,000
1968	358,000
1969	729,000
1970	342,000
1971	413,000
1972	500,000
1973	831,000

If it were considered that the past 5 years of revenue from lease bonuses and rentals reasonably could be projected into the future, the value of this future cash flow through a 25-year period, discounted at an approximate future money cost of 8 percent, would accumulate to $6,246,000. In our opinion, this provides an external verification of the tract-by-tract values which are summarized in Table 3, and total to $6,368,000.

It should be recognized that a market evaluation of around 1400 separate tracts can be considered valid only in the aggregate. If these mineral interests were offered for sale on a competitive basis, the values received for individual tracts would, no doubt, vary from the individual values estimated herein, both higher and lower, dependent

Exhibit A to Davis Affidavit.

on the opinions of individual tract bidders. In the aggregate, however, these values are considered to be a reasonable expression of present market value of all mineral interests if they were to be offered for sale under an unrestricted bidding arrangement.

Source of Data

All information pertaining to the character of ownership in the producing oil and gas properties and in the nonproducing mineral interests and all basic geological and engineering data have been accepted as represented by Kirby. In addition, we have relied on certain records in our files and in public records. Independent well tests were not considered to be necessary in connection with the appraisal of the producing properties because of the extent of corroborating data available. The management and staff of Kirby Lumber Corporation cooperated fully in the collection of data and in discussing factual situations which had a bearing on the appraisal.

All oil reserves are expressed in United States barrels of 42 gallons and all gas reserves are expressed in thousand standard cubic feet at contractual pressure and temperature bases.

Supporting work papers pertinent to the appraisal and market value opinions expressed herein are retained in our files and are available to you or to other designated parties at your convenience.

Respectfully submitted,

RIGGS AND ASSOCIATES

Roy B. Riggs, Jr.
Roy B. Riggs, Jr.
Professional Engineer

RBRjr:lcb
No. 116

Exhibit A to Davis Affidavit.

Table 1

ECONOMIC ANALYSIS OF FUTURE PERFORMANCE

Proved Producing Oil and Gas Reserves

Royalty Interests of Kirby Lumber Corporation[1]

January 1, 1974

SUMMARY

Year	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding F.I.T.) $	Cumulative Net Revenue, $	Cumulative Discounted Net Revenue @8% Per Year, $
1974	80,563	636,036	611,660	3,847	607,813	607,813	584,867
1975	69,445	583,568	554,143	3,510	550,633	1,158,446	1,075,464
1976	54,780	500,774	447,917	3,449	444,468	1,602,914	1,442,136
1977	42,541	426,751	357,635	3,154	354,481	1,957,395	1,712,914
1978	32,875	300,164	258,740	1,755	256,985	2,214,380	1,894,673
1979	23,677	188,090	169,893	1,006	168,887	2,383,267	2,005,274
1980	15,177	54,167	82,470	454	82,016	2,465,283	2,055,006
1981	9,803	42,177	55,966	398	55,568	2,520,851	2,086,207
1982	3,834	8,035	19,200	115	19,085	2,539,936	2,096,127
1983	883	—	3,719	—	3,719	2,543,655	2,097,917
1984	817	—	3,438	—	3,438	2,547,093	2,099,449
1985	750	—	3,157	—	3,157	2,550,250	2,100,752
1986	692	—	2,912	—	2,912	2,553,162	2,101,865
1987	633	—	2,666	—	2,666	2,555,828	2,102,808
1988	108	—	456	—	456	2,556,284	2,102,957
Total	336,578	2,739,762	2,573,972	17,688	2,556,284		
						14% Discount	1,856,496
						20% Discount	1,663,242
						40% Discount	1,245,155

[1] Includes minor working interests.

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
LOUISIANA								
Kirby Lease No. 76								
Bancroft, North Field (Beauregard Parish)								
Sabine A-2 Sand Unit	14,970	149	65,140	—	65,140	52,187	8.9	Atlantic Richfield Company
TEXAS								
Kirby Lease No. 47								
Cleveland Field (Liberty County)								
Kirby Lumber Corp. "C" Lease	22,974	11,484	103,030	—	103,030	88,033	5.8	Gulf Oil Corporation
Cleveland (Cockfield "A", East Segment) Field (Liberty County)								
Kirby Lumber Corp. "C" Lease	7,303	31,566	43,088	—	43,088	37,133	4.8	Gulf Oil Corporation
Cleveland (5800 Yegua) Field (Liberty County)								
Kirby Lumber Corp. "C" Lease, Well 26-U	3,932	559,462	223,914	—	223,914	185,793	6.0	Gulf Oil Corporation
Kirby Lumber Corp. "C" Lease, Well 32-U	—	45,604	16,874	—	16,874	15,827	2.0	Gulf Oil Corporation
Total Cleveland (5800 Yegua) Field	3,932	605,066	240,788	—	240,788	201,620		

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Cleveland (9000 Wilcox) Field (Liberty County)								
Kirby Lumber Corp. "C" Lease, Well 21	—	101,004	37,373	—	37,373	31,484	6.0	Gulf Oil Corporation
Total Kirby Lease No. 47	34,209	749,120	424,279	—	424,279	358,270		
Kirby Lease No. 52								
Segno (Deep) Field (Polk County)								
Kirby Lumber Corp. "B" Lease	2,573	—	10,987	—	10,987	9,011	6.0	Buddy Brown
Kirby Lease No. 53								
Schwab (Wilcox) Field (Polk County)								
Kirby-West Lumber Co. Lease	578	—	2,432	—	2,432	2,284	1.6	Patrick & Richie
Kirby-West Lumber Co. Lease	16,249	—	68,411	—	68,411	45,971	14.2	Shell Oil Company
Kirby-West Lumber Co. "C" Lease	3,056	—	12,862	—	12,862	10,361	6.8	Paul Yowell
Total Kirby Lease No. 81	19,551	—	83,705	—	83,705	58,616		
Kirby Leases 80 and 81								
Nona Mills Field (Hardin County) Nona Mills Unit (1)	7,794	345,427	113,351	3,162	110,189	90,883	6.0	General Crude Oil Company

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Kirby Lease No. 85-4 Hillistre, East Field (Tyler County) Kirby Lumber Corp. Tract 87A	30,894	12,350	131,671	—	131,671	107,851	6.5	General American Oil Co. of Texas
Hillistre, East (Cockfield Fifth) Field (Tyler County) Kirby Lumber Corp. Tract 87-A	30,533	12,225	130,132	—	130,132	101,726	8.5	General American Oil Co. of Texas
Total Kirby Lease No. 85-4	61,427	24,575	261,803	—	261,803	209,577		
Kirby Lease No. 85-10 Pavry Southeast (Wilcox 8400) Field (Hardin County) Kirby Lumber Corp. Tract 10-A	3,067	122,650	61,970	—	61,970	54,952	4.0	Shell Oil Company
Kirby Lease No. 85-11 Silsbee North (Yegua-2) Field (Hardin County) Kirby Lumber Corp. Tract 126-A	4,144	—	18,066	—	18,066	16,049	3.4	Petroleum Corporation of Texas

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Kirby Lease No. 86 Bancroft North (Wilcox) Field (Newton County) Kirby Lumber Corp. "D" Lease	12,131	—	52,770	—	52,770	41,299	8.5	Atlantic Richfield Company
Kirby Lease No. 151 Fisher (Wilcox First) Field (Tyler County) Kirby (No. 117 Hardin) Lease	2,614	—	22,346	—	22,346	19,786	4.0	Finkelstein, Jack, Trust
Kirby Lease No. 164 Village Mills (North 6500) Field (Hardin County) Kirby Lumber Corp. Lease	14,000	—	60,901	—	60,901	53,228	4.9	Houston Oil & Minerals
Village Mills (North 6750) Field (Hardin County) Kirby Lumber Corp. Lease	15,750	—	68,513	—	68,513	56,719	6.7	Houston Oil & Minerals
Total Kirby Lease No. 164	29,750	—	129,414	—	129,414	109,947		

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Kirby Lease No. 185 Segno North (Wilcox) Field (Polk County) Kirby Lumber Corp. Lease	2,247	1,581	9,774	—	9,774	8,732	1.5	Monsanto Company
Kirby Lease No. 229 Batson, New Field (Hardin County) Kirby Lumber Corp. Lease	12,780	—	52,523	—	52,523	41,145	7.8	Amoco Production Company
Kirby Lease No. 238 Schwab (Wilcox) Field (Polk County) Kirby Lumber Corp. Lease	9,438	—	39,733	—	39,733	31,630	7.1	Shell Oil Company
Kirby Lease No. 265 Gist, West (6700) Field (Jasper County) Kirby Lumber Corp. Lease	614	53,888	15,536	—	15,536	13,413	6.0	La Coastal Petroleum
Kirby Lease No. 269 Ace, North (4350) Field (Polk County) Kirby Lumber Corp. Tract 7 ..	16,283	5,683	68,585	—	68,585	57,271	8.0	Finch-Crestmont

Exhibit A to Davis Affidavit.

Table 2
SUMMARY OF NET RESERVES AND ECONOMIC VALUES
Proved Producing Oil and Gas Reserves
ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)
January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Ace, North (4830) Field (Polk County) Kirby Lumber Corp. Tract 11 ..	—	4,432	789	—	789	759	1.0	Crestmont Oil & Gas Company
Total Kirby Lease No. 269	16,283	10,115	69,374	—	69,374	58,030		
Kirby Lease No. 291 Bleakwood (Wilcox "A") Field (Newton County) Kirby-ARCO Lease	13,809	--	58,683	—	58,683	46,890	8.6	White Shield Oil & Gas Corp.
Kirby Lease No. 300 Silsbee, North (Yegua 4-C) Field (Hardin County) Kirby Lumber Corp. Lease	6,447	109,600	52,415	—	52,415	45,027	5.0	Coline Oil Corporation
Kirby Lease No. 308 Clay Point (Kurth) Field (Newton County) Kirby Lumber Corp. Lease	25,550	537,500	275,650	—	275,650	212,106	4.2	Neil F. Hanson

Exhibit A to Davis Affidavit.

Table 2

SUMMARY OF NET RESERVES AND ECONOMIC VALUES

Proved Producing Oil and Gas Reserves

ROYALTY INTERESTS OF KIRBY LUMBER CORPORATION (1)

January 1, 1974

State, Kirby Lease No., Field, Parish/County, Lease	Net Oil Production, Barrels	Net Gas Production, Mcf	Revenue, $	Expenses (Excluding Depreciation) Plus Ad Valorem Taxes, $	Net Revenue (Excluding (F.I.T.), $	Cumulative Discounted Net Revenue @8% Per Year, $	Future Life Years	Operator
Kirby Lease No. 318 Yonajosa West Field (Hardin County)								
Kirby Lumber Corp. Lease, Well 1	16,000	4,030	93,387	4,897	88,490	68,905	8.8	North American Royalties, Inc.
Kirby Lumber Corp. Lease, Well 2	—	437,725	179,118	9,629	169,489	144,349	4.4	North American Royalties, Inc.
Total Kirby Lease No. 318	16,000	441,755	272,505	14,526	257,979	213,254		
Kirby Lease No. 325 Segno, South (Yegua 5-C) Field (Hardin County)								
ARCO-Kirby Gas Unit 1	258	25,652	12,537	—	12,537	10,641	6.0	Bock & Bacon
Kirby Lease No. 357 Undesignated Field (Hardin County)								
Kirby-Vickers Lease, Well 1 ..	40,600	317,750	471,411	—	471,411	401,512	5.5	Bock & Bacon and McCormick
GRAND TOTAL	336,578	2,739,762	2,573,972	17,688	2,556,284	2,102,957		

Footnote:
(1) Includes minor working interests.

Exhibit A to Davis Affidavit.

Table 3

MINERAL OWNERSHIP AND MARKET VALUE ESTIMATE

Kirby Lumber Corporation

Louisiana and Texas

January 1, 1974

State, Parish/ County	Net Minerals, Acres (1)	Estimated Market Value of Minerals at January 1, 1974 (2) Per Acre	Total
LOUISIANA			
Beauregard	11,137	$24.43	$ 272,037
Vernon	26,797	24.26	650,189
TEXAS			
Angelina	2,458	20.00	49,160
Brazoria	360	45.90	16,524
Cameron	220	10.00	2,200
Hardin	73,668	20.27	1,493,201
Jasper	41,536	14.52	603,025
Jefferson	760	20.00	15,200
Liberty	34,636	17.27	598,234
Montgomery	11	12.00	132
Nacogdoches	9	12.00	108
Newton	39,061	13.24	517,042
Polk	19,280	31.53	607,866
Sabine	5,288	16.40	86,710
San Augustine	10,054	17.76	178,515
San Jacinto	1,249	25.00	31,225
Shelby	557	12.00	6,684
Tyler	46,907	26.39	1,237,958
Willacy	200	12.00	2,400
TOTAL	314,188	$20.27	$6,368,410

Footnotes:

(1) Includes Kirby Lumber Corporation's net mineral ownership in fee lands, surface lands with partial mineral ownership, mineral ownership with no surface rights, royalty ownership in surface lands, and royalty ownership under lands owned by others.

(2) Includes leased minerals currently producing, leased minerals not currently producing, and unleased minerals.

Exhibit A to Davis Affidavit.

A map of the mineral ownership of Kirby Lumber Corporation in southeast Texas and western Louisiana, attached to the preceding letter dated March 29, 1974, is not reproduced in this Exhibit E. A copy of the map is available for inspection by stockholders of Kirby Lumber Corporation at the offices of Santa Fe Natural Resources, Inc. at the following address:

Suite 1426
224 South Michigan Avenue
Chicago, Illinois 60604
(312) 427-2232

Amended Complaint.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Civil Action
No. 3915 (CLB)

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of LOUIS A. GREEN, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs,

—against—

SANTE FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN, STANLEY & CO.,

Defendants.

AMENDED COMPLAINT

For Equitable Relief, Damages, and Other Relief under Federal and State Law.

1. This is a civil action—derivative, class, and individual—for equitable and other relief. As to all defendants, this Court has federal question jurisdiction under the Securities Exchange Act of 1934 and pendent jurisdiction over the State claim for breach of fiduciary obligation; and except for Morgan Stanley & Co., diversity jurisdiction over said state claims.

2. Plaintiffs were shareholders of Kirby Lumber Corporation, a Delaware corporation ("Kirby") at the time of the transaction herein complained of and have continuously been and are now stockholders thereof; this action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have and plaintiffs fairly and adequately represent the interests of the shareholders similarly situated in enforcing the rights of Kirby. Each plaintiff is a citizen of New York State and as to each plaintiff the matter in controversy exceeds, exclusive of interest and costs, the sum of ten thousand dollars.

3. The class of stockholders of Kirby is so numerous that joinder of all is impracticable; the action presents questions of law and fact common to the class; the claims of plaintiffs herein are typical of the claims of the class; plaintiffs will fairly and adequately protect the interests of the class. This action falls within the Federal Rules of Civil Procedure, Rule 23(b)(1)(A) and (B) and (2) and (3).

4. Santa Fe Industries, Inc. ("Santa Fe") owns all the capital stock of Santa Fe Natural Resources, Inc. ("Resources") which owns approximately 95% of the capital stock of Kirby. Kirby, Sante Fe and Resources, are each a corporation incorporated under the laws of the State of Delaware and each of them has its principal place of business in a State other than New York State.

5. On July 31, 1974, without prior notice to plaintiffs or the other public stockholders of Kirby, Forest Products, Inc. ("FPI") was merged into Kirby with Kirby surviving the merger. The purpose of the merger was to cause Kirby to become a wholly-owned subsidiary of Resources thereby freezing out the minority stockholders at a wholly inadequate price. In order to utilize the provisions of Section 253 of the General Corporation Law of the State of Delaware ("Delaware Corporation Law"), as described below, Resources caused FPI to be incorporated in Delaware on July 11, 1974. On July 29, 1974, FPI became the parent corporation of Kirby owning approximately 95% of the issued and outstanding Capital Stock of Kirby. On that date, FPI issued to Resources 1,000 shares of FPI Capital Stock in exchange for (i) 474,675 ½ shares of Kirby Capital Stock, and (ii) cash in the amount of $3,798,675 and (iii) the assumption of any other expenditures of FPI or Kirby arising out of or resulting from the merger of FPI into Kirby. On July 30, 1974, the board of directors of FPI (which consisted of the same persons who are members of the board of directors of Resources) adopted a resolution of merger pursuant to Section 253 of the Delaware Corporation Law, providing that FPI would be merged into Kirby with Kirby surviving and that each share of Kirby stock not owned by FPI would represent only (i) a right to receive the amount of $150 per share in cash in exchange therefor, or (ii) a right to seek such appraisal for such stock as is available under Delaware law. Holders of shares of Kirby stock other than FPI, to wit, holders of 25,324 ½ shares, are entitled thereunder to receive the $150 per share payment in cash upon surrender of their certificates for such shares to the Kirby Paying Agent. Resources as sole stockholder of FPI approved the merger on July 30, 1974; no meeting of Kirby stockholders was required in connection with the FPI-Kirby merger. The merger became effective on July 31, 1974 when the Certificate of Ownership and Merger was filed with the Secretary of State of the State of Delaware. On August 1, 1974, the minority stockholders of Kirby were advised, *inter alia,* that the merger freezing them out as stockholders had taken place the previous day and that they would be paid $150 per share.

6. Section 253 of the Delaware Corporation Law permits a parent corporation owning at least 90% of the capital stock of a subsidiary to cause a merger of the parent corporation into the subsidiary by the adoption of a resolution of merger by the parent's board of directors. Approval by the stockholders of the board of the subsidiary corporation is not required. However, approval by the stockholder of the parent corporation is necessary. Section 253 permits, in a merger pursuant to its provisions, the outstanding stock of the subsidiary other than the stock held by the parent to be exchanged for securities, cash, property or rights, other than stock in the surviving corporation. Thus, under a merger pursuant to Section 253, a parent corporation (FPI) owning at least 90% of the stock of a subsidiary (Kirby) may cause the subsidiary (Kirby) to become a wholly owned subsidiary of the stockholder (Resources) of the parent (FPI) by providing in the resolution of merger that stockholders other than the parent shall receive cash in exchange for their shares.

7. The said value of $150 per share was based primarily on Kirby's book value, whereas based on fair market values of its physical assets, the pro rata share thereof at the date of the merger was at least $772 per share. The difference of $311,000,000 ($622 per share) between the fair market value of Kirby's land and timber, alone, as per the defendants' own appraisal thereof at $320,000,000 and the $9,000,000 book value of said land and timber, added to the $150 per share, yields a pro rata share of the value of the physical assets of Kirby of at least $772 per share. The value of the stock was at least the pro rata value of the physical assets.

8. In addition, the majority stockholder has arranged the transaction as tax free to itself while imposing a capital gains tax on the minority stockholders.

9. The purpose of creating FPI was to effect a statutory merger with Kirby under the color of the Delaware law, all for the purpose of getting rid of the minority interest in Kirby, but at the same time keeping Kirby in existence, and thereby to appropriate at least $622 per share from the minority shareholders by only paying them $150 per share even though the conceded pro rata value of the physical assets of Kirby was at least $772 per share, which on the plaintiffs' 143 shares amounted to an appropriation of $88,946, and on the entire class of 25,324 ½ minority shares outstanding amounted to an appropriation of $15,751,839. With knowledge of the above values, the defendants as part of the scheme obtained and submitted a fraudulent appraisal from defendant Morgan Stanley & Co., a copartnership, valuing each share of stock of Kirby at $125 per share and in order to lull the minority stockholders into erroneously believing that defendants were generous, fixed a value $25 higher than the Morgan Stanley & Co. appraisal, to wit, $150 per share. The above transaction implemented by the use of means or instrumentalities of interstate commerce including U.S. mail and telephone and without prior disclosure to the stockholders, who were thus frozen out constituted a violation of Rule 10b-5 because defendants employed a "device, scheme, or artifice to defraud" and engaged in an "act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Defendants also thereby breached their fiduciary obligation owed to Kirby and its minority stockholders. The corporate defendants participated in said breaches as principals. Morgan, Stanley & Co. is liable (but only in so far as federal question and pendent jurisdiction are asserted) as an accessory in that it knowingly assisted and facilitated such fraud by submitting an appraisal of the stock at $125 per share even though said defendant knew the pro rata value of the physical assets of Kirby was at least $772 per share.

10. Plaintiffs have by notice mailed September 9, 1974 to Kirby its directors and controlling stockholder, and theretofor, objected to the said merger and its terms and demanded that the merger be rescinded or, failing that, that all the minority stockholders of Kirby be offered at least $772 per share plus a reasonable amount to compensate for the capital gains tax.

11. Santa Fe and Resources have at all material times owned 95% of the stock of Kirby and controlled and dominated its board of directors and dictated the terms of the wrongful merger. Demand on the board of directors and stockholders of Kirby for relief is therefore futile.

12. Plaintiffs have no adequate remedy at law.

WHEREFORE, plaintiffs pray for an order that their action in so far as brought as a class action may be maintained as such and demand judgment:

(a) That the merger aforesaid be set aside; or

(b) That the terms of the aforesaid merger be reformed so that they are just, fair and equitable; and

(c) That the Court give such other, further, and different relief as may be just, including damages, together with interest, costs, disbursements and a reasonable fee for plaintiffs' attorneys.

LEVENTRITT LEWITTES & BENDER

By Sidney Bender
Sidney Bender
a member of the firm
Attorneys for the Plaintiffs
405 Lexington Avenue
New York, N.Y. 10017

(Verification omitted)

Opinion of the District Court.

S. William Green, et al.,
Plaintiffs,

v.

Santa Fe Industries, Inc., et al.,
Defendants.
No. 74 Civ. 3915 CLB.

United States District Court,
S. D. New York.
March 27, 1975.

Leventritt, Lewittes & Bender by Sidney Bender, New York City, for plaintiffs.

Rogers & Wells, New York City by William R. Glendon and Guy C. Quinlan, New York City, for defendants Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc. and Kirby Lumber Corp.

Davis, Polk & Wardwell by S. Hazard Gillespie, James W. B. Benkard, and Charles R. Morgan, New York City, for defendant Morgan Stanley & Co.

Memorandum and Order

Brieant, District Judge.

Plaintiffs seek to maintain this purported class action on behalf of all of the former shareholders of Kirby Lumber Corporation ("Kirby"), a Delaware corporation, who were offered or received cash for their shares when Kirby and Forest Products, Inc. ("FPI") were merged. Plaintiffs also sue derivatively to enforce the rights of Kirby as it existed prior to the merger (hereinafter "Old Kirby").

Jurisdiction is premised on § 27 of the Securties Exchange Act of 1934, 15 U.S.C. § 78aa; this Court's jurisdic-

tion depends, therefore, upon the existence of a cognizable claim under Rule 10b-5. Plaintiffs also assert that this Court has pendent jurisdiction over related claims of the defendants' breach of their fiduciary duties. The complaint asserts jurisdiction by reason of diversity of citizenship, but complete diversity does not exist, as is conceded in ¶ 1 of the first amended complaint.

Defendants moved for an order pursuant to Rules 12(b)(1), and (6), F.R.Civ.P., dismissing the amended complaint for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted. Alternatively, defendants seek dismissal of the amended complaint for failure to satisfy Rule 9(b), F.R.Civ.P., because it does not state the circumstances constituting the claimed fraud with sufficient particularity.

The amended complaint shows that defendant Santa Fe Industries, Inc. owns all of the capital stock of Santa Fe Natural Resources, Inc., which, in turn, owned approximately 95% of the voting shares of Old Kirby. On July 11, 1974, Santa Fe Resources caused FPI to incorporate in Delaware. On July 29, 1974, FPI issued 1,000 shares [all] of its stock to Santa Fe Resources and received in return 474,675½ shares of Kirby which constituted approximately 95% of Kirby's shares, and all of those shares then owned by Santa Fe Resources. FPI also received $3,798,675.00 in cash and assumed expenses arising as a result of the contemplated merger of FPI and Kirby to form New Kirby. On July 30, 1974, the board of directors of FPI, the same persons who comprised the board of directors of Santa Fe Resources, adopted a resolution, pursuant to § 253 of the Delaware Corporation Law, that state's short-form merger statute, providing that FPI be merged into Kirby with Kirby surviving the merger. Shareholders of Old Kirby, other than FPI, would become entitled to $150.00 in cash per Kirby share held, and would cease being shareholders of Kirby effective immediately. On the next day the cus-

tomary Certificate of Ownership and Merger was filed with the Secretary of State of the State of Delaware, and the merger became effective, thereby extinguishing, or "freezing out" the minority shareholders of Kirby.

On August 1, 1974, New Kirby mailed to each former minority shareholder a notice of merger and an information statement consisting of 33 pages and supplementary exhibits. The information statement contained the terms of the plan of merger, a statement of Kirby's income, appraisals of the value of Kirby's stock and its assets, and a history of the prior dealings between Kirby and Santa Fe Industries and its affiliates. Exhibit C attached to the information statement is a copy of a letter from defendant Morgan, Stanley & Co. in which Morgan, Stanley, after consideration of Kirby's audited financial statements for the five years ending December 31, 1973, its unaudited financial statements for the four-month period ending April 30, 1974, its five-year forecast for 1974-78, and appraisals of Kirby's properties and mineral rights, placed a value on the minority shareholders' stock at $125.00 a share, adjusting for the assumption that Kirby's shares were broadly distributed and freely traded at prices within the range of prices typical of similar publicly held companies. The information statement also advised the minority shareholders that they could elect not to accept the terms of the offer, and instead seek a judicial appraisal in Delaware of the value of their shares. The information statement clearly described the time limitations within which the dissenting shareholders were to note their objection, and the time within which the appraisal action was to be commenced; it also included the text of the Delaware appraisal statute, Del.Gen.Corp.Law, § 262.

In their complaint, plaintiffs allege that the merger, its statutory means of effectuation and the cash exchange offered, constituted a "device, scheme or artifice to defraud"

in violation of Rule 10b-5. Plaintiffs contend that, with knowledge that the $150.00 a share offer understated the value of the physical assets of Kirby and therefore did not represent the true value of Kirby shares, Kirby and the Santa Fe affiliates obtained and submitted to the minority shareholders the $125.00 a share valuation from Morgan, Stanley "in order to lull the minority stockholders into erroneously believing (sic) that defendants were generous." (Complaint, ¶ 9). It is alleged further that Morgan, Stanley assisted knowingly and facilitated the fraud.

Plaintiffs' allegations have two distinct aspects. First, it is alleged that the means of effectuating this merger operated as a fraud on the minority shareholders in that the merger was consummated for the benefit of the majority shareholders, without any justifiable business purpose, except to freeze out the minority, and was effected without prior notice to the minority shareholders. Second, plaintiffs allege that the low valuation placed on their shares in the cash exchange offer segment of the merger transaction was in itself a fraud actionable under Rule 10b-5.

Plaintiffs' attack upon the Delaware short-form merger procedure based, as it is, upon Rule 10b-5 is without merit. The General Corporation Law of the State of Delaware permits a parent corporation to merge with another corporation, 90% of whose shares are owned by the parent, by executing and filing a certificate of ownership and merger together with a copy of the resolution of the board of directors of the parent. Del.Gen.Corp.Law, § 253 (a). *See generally,* N.Y.B.C.L., § 905 (McKinney's Consol. Laws, c. 4, Supp.1974); Stauffer v. Standard Brands Incorporated, 41 Del. Ch. 7, 187 A.2d 78 (Del.Sup.Ct.1962). The resolution of the board of directors may provide that minority shareholders are to receive cash in payment for their shares in the subsidiary although this has the effect of causing these shareholders to make a forced sale. See

Vine v. Beneficial Finance Company, 374 F.2d 627 (2d Cir. 1967). Plaintiffs did not have a vested right to remain shareholders of Kirby. Coyne v. Park & Tilford Distillers Corporation, 37 Del.Ch. 558, 146 A.2d 785 (Del.Ch.1958), aff'd, 38 Del.Ch. 514, 154 A.2d 893 (Del.Sup.Ct.1959); Matter of Willcox v. Stern, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401 (1966). The corporation law of a state may permit minority shareholders to be "frozen out" or to be "frozen in." Garzo v. Maid of the Mist Steamboat Co., 303 N.Y. 516, 104 N.E.2d 882 (1952). The Delaware corporation law does not require that the merger be effected for a business purpose. The statute reflects the public policy of Delaware with respect to rights of splinter interests in corporations. The Court does not view Rule 10b-5 as requiring a federal district court to analyze the motives of corporate directors, at least not in the absence of actual fraud and deceit. See Grimes v. Donaldson, Lufkin & Jenrette, Inc., Fed.Sec.L.Rep., ¶ 94,722 (N.D.Fla.1974); *cf.* Bryan v. Brock & Blevins Co., Inc., 490 F.2d 563 (5th Cir. 1974). "[T]he very purpose of the [Delaware short-form merger] statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise." Stauffer v. Standards Brands Incorporated, *supra,* 187 A.2d 80. See generally Borden, "Going Private—Old Tort, New Tort or No Tort?", 49 N.Y.U.L. Rev. 987 (1974).

When a merger is effected under this statute and all of the subsidiary's shares are not owned by the parent corporation, the merger statute requires that the surviving corporation *"within 10 days after the effective date* of the merger, notify each shareholder . . . that the merger has become effective," Del.Gen.Corp.Law, § 253(d) (emphasis added); Carl Marks & Co. v. Universal City Studios, Inc., 233 A.2d 63 (Del.Sup.Ct.1967). It is not contended that Kirby failed to comply with this notice requirement, rather

it is argued that the anti-fraud provisions of the 1934 Act require prior notice and disclosure to the minority shareholders. The primary objective of Rule 10b-5 is to impose a duty of disclosure upon a corporation and its controlling persons. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). That objective is to be achieved in conjunction with the state corporate law. This Court does not regard Rule 10b-5 as an omnibus federal corporation law having such broad reach as to modify the notice requirements of the Delaware merger statute, or prevent Delaware, in its legislative wisdom, from providing a means by which a majority can exclude a minority from the corporation's future affairs, so long as due process is satisfied, as it is here, by the appraisal procedures.

Plaintiffs contend further that the corporate defendants knowingly obtained an appraisal from defendant Morgan, Stanley which undervalued the worth of their Kirby stock so drastically as to be a fraud within the purview of Rule 10b-5. Plaintiffs value their shares at a minimum of $772.00 each, basing this figure on the *pro rata* value of Kirby's physical assets. For purposes of this motion the Court accepts plaintiffs' claimed valuation, although the propriety of using the liquidation value of Kirby's physical assets as the sole basis for determining the true worth of the shares owned by the minority shareholders is at least questionable. See In re Olivetti Underwood Corporation, 246 A.2d 800, 803 (Del.Ch. 1968); Application of Delaware Racing Association, 213 A.2d 203 (Del.Sup.Ct. 1965).

Accepting plaintiffs' valuation, the amended complaint, upon its face, fails to allege a course of fraudulent conduct.[1] In paragraph seven of their complaint, plaintiffs

[1] On oral argument, plaintiffs conceded that if the differential between price and true value was so slight that reasonable minds could differ, no action would lie under Rule 10b-5.

acknowledged that their valuation is based upon information provided by the corporate defendants in the merger information statement. The appraisal made by defendant Morgan, Stanley details the information upon which it relied in computing the value of the minority's shares in Kirby. Among the considerations relied upon by Morgan, Stanley were the values of Kirby's physical assets provided by Appraisal Associates and Riggs and Associates. The opinions of the latter two firms were appended to the merger information statement as Exhibits D and E, and the entire report of Appraisal Associates was available for inspection at the offices of Santa Fe Resources. The appraisal opinions, and detailed financial information, were provided for the minority shareholders' use in evaluating the merits of the cash exchange offer and in determining whether to seek their appraisal rights as dissenting shareholders.

Without passing upon the proper valuation of the Kirby shares, it is noteworthy that the information statement divulged the history of purchases of Kirby stock by the Santa Fe affiliates. Following the paradigm of "going private" transactions, an affiliate of Santa Fe made a tender offer for the shares of Kirby in 1967 and acquired 27,979½ shares at $65.00 per share. In the period from 1968 through 1973, Santa Fe affiliates purchased shares at prices ranging from $65.00 to $92.50 per share. None of the Santa Fe affiliates had acquired any Kirby stock since October 1973. The history of Santa Fe's affiliates' prior purchases provided plaintiffs with another basis of comparison for evaluating the merits of the exchange offer.

The complaint demonstrates merely that the parties to this action differ in their computation of the fair value of plaintiffs' shares. Whatever the information statement indicates about the fair value of plaintiffs' shares,

the value of the physical assets "was discernible, as plaintiff[s] discerned it." Tanzer Economic Associates, Inc. v. Haynie, 388 F. Supp. 365, 369 (S.D.N.Y. 1974). See also, Spiegler v. Wills, 60 F.R.D. 681 (S.D.N.Y. 1973). The inadequacy of the offering price, standing alone, does not demonstrate bad faith or overreaching on the part of the controlling interests. See Muschel v. Western Union Corporation, 310 A.2d 904 (Del.Ch.1973).

In Dreier v. The Music Makers Group, Inc. (1973-74) CCH Fed.Sec.L.Rep ¶ 94,406 (S.D.N.Y. February 20, 1974), a suit alleging a violation of Rule 10b-5 in connection with the merger of a publicly held corporation, The Music Makers Group, Inc., into a privately owned company, Leigh Group, Inc., effectuated by the voting power of Leigh Group, Inc., the majority shareholders of Music Makers Group, Inc., the Court dismissed the amended complaint holding that

> "non-disclosure remains an essential element in any section 10(b)-Rule 10b-5 action. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). The instant complaint does not allege any non-disclosure in connection with the merger; the treatment of the minority shareholders may well have been grossly unfair but it was completely open. Under these circumstances plaintiff's remedy is a state court action for appraisal pursuant to the Delaware Corporation Law." *Id.*, at 95,410. *Accord*, Popkin v. Bishop, *supra;* Kaufmann v. Lawrence, 386 F.Supp. 12 (S.D.N.Y.1974)

If adequate disclosure is made, "[u]nderlying questions of the wisdom of [merger freeze-out] transactions or even their fairness become tangential at best to federal regulation." Popkin v. Bishop, *supra*, 464 F.2d 720. See also, Armour and Company v. General Host Corporation, 296 F.Supp. 470 (S.D.N.Y.1969).

It was for each shareholder to determine, on the basis of the information provided, whether the price offered was adequate or whether he should seek a judicial appraisal. The instant complaint fails to allege an omission, misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer. *Cf.* Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y.1974).

At least, if full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5. Support for this proposition is found in the Securities and Exchange Commission's ("SEC") own estimate of the reach and the limitations of existing regulations in dealing with "going private" transactions. The interpretation propounded "by an agency charged with the administration of a statute, while not conclusive, is entitled to substantial weight." Zeller v. Bogue Electric Manufacturing Corporation, 476 F.2d 795 (2d Cir.), cert. denied, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973). The SEC has promulgated proposed rules which would subject such transactions to comprehensive regulation. See Proposed Rules 13e-3A and 13e-3B, 2 Fed. Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. Notably, Proposed Rule 13e-3B(a) would make unlawful a shareholder freezeout transaction unless the transaction has "a valid business purpose" other than getting rid of a minority which might or does impede the will of the majority; and "the terms of [the] transaction, including any consideration to be paid to any security holder, are fair."

Another proposed SEC regulation would require, notwithstanding the provisions of a state's corporate law, that notice of the terms of any freeze-out transaction be sent to shareholders no later than 20 days prior to "authorization"

of the transaction. Proposed Rule 13e-3A(c)(1). In addition to other disclosure requirements, both of the proposed rules would require that, for the consideration paid to be deemed fair, it must exceed the value placed on the securities by "two qualified independent persons." Proposed Rule 13e-3A(c)(2).

Implicit in the Commission's expressed intent to enact these or similar rules is the conclusion, which this Court shares, that existing rules, including Rule 10b-5, do not reach the acts here complained of.

Assuming *arguendo* that the merger information statement did not constitute adequate disclosure, the amended complaint does not demonstrate a causal connection between the alleged deception and plaintiffs' damages. Plaintiffs did not tender their shares for cancellation and payment pursuant to this merger plan. On August 1, 1974, the information statement was mailed to the minority shareholders. On August 21, 1974, the plaintiffs made a demand for an appraisal of their shares pursuant to Delaware statute, but, by letter dated September 9, 1974, they purported to withdraw this demand. On September 10, 1974, plaintiffs commenced this action. From the outset, plaintiffs recognized the alleged deception and did not rely upon it.

In a freeze-out merger, reliance need not be shown, Vine v. Beneficial Finance Company, *supra*, 374 F.2d 635; however, there must be some causal connection between the wrong done and the harm suffered. See Schlick v. Penn-Dixie Cement Corporation, 507 F.2d 374 (2d Cir. 1974); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974). In *Vine, supra*, although finding that no misrepresentation was made to the minority shareholders in a short-form merger, and that, therefore, there could be no reliance in the traditional sense, the Court found an actionable 10b-5 claim on the

basis of misrepresentations made in the course of the parent company's acquisition of the shares needed to effect the short-form merger. See also, Voege v. American Sumatra Tobacco Corporation, 241 F.Supp. 369 (D.Del. 1965). No allegation is made here that the Santa Fe affiliates acquired their dominant interest by means of a fraud. In sum, the instant complaint fails to satisfy even the relaxed standard of causation which must be shown to sustain an action as a "forced seller" under Rule 10b-5.

In finding that there is no causal connection, it may be added that the Court is not applying a standard of "but for" causation and does not view the Santa Fe affiliates as being immune from suit merely because the resulting merger could be effectuated without any action by the minority. See Swanson v. American Consumer Industries, Inc., 415 F.2d 1326 (7th Cir. 1969); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385, n. 7, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); *cf.* Kraficisn v. LaSalle Madison Hotel Co., (1972-73) CCH Fed.Sec.L.Rep. ¶ 93,586 (N.D.Ill. 1972). Rather, the Court finds that these plaintiffs in their complaint fail to allege that they relied to their detriment on the alleged misrepresentation and were injured thereby.

For the foregoing reasons, it appears that the amended complaint fails to state a claim under the federal securities laws. Since the complaint fails to state a federal claim, exercise of pendent jurisdiction to adjudicate common law claims of breach of fiduciary duty is inappropriate. Kavit v. A. L. Stamm & Co., 491 F.2d 1176 (2d Cir. 1974).

Diversity jurisdiction will not lie in the absence of complete diversity of citizenship between all parties plaintiff and all parties defendant. Strawbridge v. Curtiss, 3 Cranch 267, 2 L.Ed. 435 (U.S. 1806). The amended complaint states (¶ 1) that there is no diversity of citizenship between the plaintiffs and defendant Morgan, Stanley.

Plaintiffs lack standing to maintain this action derivatively in the right of Old Kirby. Under Delaware law, as a result of a merger, the derivative rights of the merged subsidiary pass to the surviving corporation. Bokat v. Getty Oil Co., 262 A.2d 246 (Del.Sup.Ct. 1970); Braasch v. Goldschmidt, 41 Del. Ch. 519, 199 A.2d 760 (Del. Ch. 1964); Heit v. Tenneco, Inc., 319 F.Supp. 884 (D.Del. 1970). See also, Voege v. Ackerman, 364 F.Supp. 72 (S.D.N.Y. 1973). Assuming however, that the plaintiffs retain their rights as shareholders of Old Kirby after the merger, a derivative recovery would be an inappropriate remedy. If plaintiffs were to be successful on their derivative claims, the benefits would enure either to a corporation that is no longer functioning or to the entire class of Kirby shareholders, including the Santa Fe affiliates who are the purported malefactors. Vine v. Beneficial Finance Company, *supra,* 374 F.2d 637; de Haas v. Empire Petroleum Company, 300 F.Supp. 834 (D.Colo. 1969). See also, Johnson v. American General Insurance Company, 296 F. Supp. 802 (D.D.C. 1969).

This complaint has been amended once. Plaintiffs on the oral argument of this motion show no facts or contentions which they could assert if given further leave to serve a second amended complaint. In the absence of any such showing, this motion is granted, and the amended complaint is dismissed.

So ordered.

Judgment of the District Court.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Civ. 3915 (CLB)

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of LOUIS A. GREEN, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs,

—against—

SANTE FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION and MORGAN, STANLEY & CO.,

Defendants.

JUDGMENT

An Order of the Honorable Charles L. Brieant, United States District Judge, having been filed March 27, 1975, in favor of the defendants and against the plaintiffs, granting the defendants' motion to dismiss the amended complaint for failure to state a claim upon which relief can be granted and for lack of subject matter jurisdiction, it is

Judgment of the District Court.

ORDERED AND ADJUDGED that defendants' said motion is granted, that the amended complaint is dismissed, and that the plaintiffs recover nothing.

Dated: New York, New York
April 23, 1975.

/s/ CHARLES L. BRIEANT, JR.
U.S.D.J.

Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 157—September Term, 1975.

(Argued November 5, 1975 Decided February 18, 1976.)

Docket No. 75-7256

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of Louis A. Green, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

—against—

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN STANLEY & Co.,

Defendants-Appellees.

Before:

MEDINA, MOORE and MANSFIELD,

Circuit Judges.

Appeal from an order and judgment of the United States District Court for the Southern District of New York, Charles L. Brieant, Jr., *Judge.*

S. William Green and others, shareholders of Kirby Lumber Corporation, appeal from an order and judgment dismissing their complaint for failure to allege subject matter jurisdiction and for failure to state a claim for relief. Opinion below, 391 F.Supp. 819. Affirmed as to defendant Morgan Stanley & Co., reversed as to the other defendants.

Aaron Lewittes, New York, N.Y. (Sidney Bender and Leventritt Lewittes & Bender, New York, N.Y., on the brief), *for Plaintiffs-Appellants.*

William R. Glendon, New York, N.Y. (Guy C. Quinlan, Gene M. Bauer and Rogers & Wells, New York, N.Y., on the brief), *for Defendants-Appellees Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc., and Kirby Lumber Corporation.*

S. Hazard Gillespie, New York, N.Y. (James W. B. Benkard, Charles R. Morgan and Davis, Polk & Wardwell, New York, N.Y., on the brief), *for Defendant-Appellee Morgan Stanley & Co.*

Medina, *Circuit Judge:*

S. William Green and others, shareholders of Kirby Lumber Corporation, individually and as such shareholders, suing on behalf of themselves and for the benefit of the

corporation and for the class of all other minority shareholders of Kirby, appeal from an order of Judge Charles L. Brieant, Jr. in the Southern District of New York, dismissing their amended complaint for failure of subject matter jurisdiction and for failure to state a claim on which relief can be granted. The opinion below is reported at 391 F.Supp. 849.

This important, interesting and complicated case involves a claim, framed in a double aspect, by minority shareholders and the class they represent arising out of S.E.C. Rule 10b-5 concerning the purchase and sale of securities in interstate commerce in the setting of a short-form merger under the laws of the State of Delaware. These laws permit a majority of 90% or more of the shareholders of a Delaware corporation to squeeze out the minority without giving prior notice of the intention to do so, without any statement of a justifiable corporate reason for the merger and upon payment to the minority shareholders of an amount of dollars per share specified in the terms of the merger. The sole remedy of an objecting minority shareholder under these Delaware laws is to demand an appraisal of the value of his stock in a proceeding in the Delaware Court of Chancery.[1]

The double aspect of the claim asserted in the complaint is:

(1) that the Delaware procedure as applied to the facts of this case constitutes a "device, scheme, or artifice to

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[1] While the appraisal statute, Del. Code Ann. tit. 8 § 262 (1974) is silent on the exclusivity of the appraisal remedy, it is generally held exclusive as against one who complains of a short-form merger. See *Abelow* v. *Midstates Oil Corp.*, 41 Del. Ch. 145, 151, 189 A.2d 675, 679 (Sup. Ct. 1963); *Stauffer* v. *Standard Brands Inc.*, 41 Del. Ch. 7, 9-10, 187 A.2d 78, 80 (Sup. Ct. 1962). But see *Braasch* v. *Goldschmidt*, 41 Del. Ch. 519, 524, 199 A.2d 760, 764 (Ch. 1964).

defraud" because of the gross undervaluation by defendants of the shares the minority shareholders are forced to sell for $150 a share; and

(2) that without any misrepresentation or failure to disclose relevant facts, the merger itself constitutes a violation of Rule 10b-5 because the mulcting of the minority shareholders is accomplished by a breach by the majority of its fiduciary duty to deal fairly with the minority who in effect are the *cestuis* of the majority. This breach of fiduciary duty is the forcing of the minority to sell their stock at far less than it is worth against their will, and even without any opportunity to seek pre-merger relief from the courts, all for the enrichment of the majority who continue to hold their stock. All this is alleged to be done at the expense of the corporation without any corporate purpose justifying the expenditure.

Jurisdiction is based upon Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. Section 78aa, and exists only if the amended complaint contains allegations that on their face make out a case of fraud within the meaning of Section 10(b), 15 U.S.C. Section 78j(b) and S.E.C. Rule 10b-5, 17 C.F.R. 240.10b-5. We do not reach the pendent and diversity claims.

The judge and counsel for all parties wisely agreed, for the purposes of the motion to dismiss, to consider the entire Information Statement, including the letter of Morgan Stanley & Co. of June 24, 1974, and all the annexed Exhibits, Schedules and Appraisals, as part of the amended complaint. They also agreed to treat the allegation that the purpose of the merger was to freeze out the minority shareholders as a charge that this was not done for any justifiable corporate purpose. The subject is discussed on this basis in the opinion below. We would not have mentioned this subject had it not been for the fact that the de

fendants in a footnote on page 9 of their main brief make a halfhearted claim that by not mentioning the lack of business purpose in their main brief the appellants had "abandoned this position." We find no abandonment whatever of this very significant part of plaintiffs' claims. Appellants may have given this phase of their contentions less emphasis in order to keep Morgan Stanley & Co. in the case.

I

We do not write on a clean slate. The background of judicial decisions is truly formidable, especially as the opinions contain so many dicta that may be thought by some to be ambiguous and so many seemingly unnecessary digressions. Accordingly, we think it will be helpful to an understanding of this opinion as a whole if we refer at the outset, and before our outline of the facts, to the holdings of this Court on two of the law points crucial to the disposition of this appeal.

First. It seems to be thought that it is a complete defense to show that defendants did exactly what the laws of Delaware required in order to effectuate a short-form merger. Under Delaware law the sole remedy of the dissenting minority shareholders is the Delaware appraisal proceeding.[2] But it is settled law in the Second Circuit that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law." *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972). *See also Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Levine* v. *Biddle Sawyer Corp.,* 383 F.Supp. 618, 622 (S.D.N.Y. 1974). So, here, the principal if not the sole question we have to decide is whether or not plaintiffs

[2] *See* note 1 *supra.*

have stated a claim arising out of Rule 10b-5. The legal reasoning supporting this holding is, we think, that the states have no power to preempt Congress in the creation of substantive rights and remedies arising from purchases and sales of securities in interstate commerce. Neither Delaware nor any other state may do more than create substantive remedies that are not preemptive or exclusive but must compete with other properly constituted remedies in the market place where the most effective and least costly of those procedures may be expected to prevail. The remedies available to redress violations under the Securities Exchange Act are supplementary to those provided by the states and they may not be abrogated merely by the coincidental availability of an alternate or corollary state remedy. Furthermore, the fact that a state has chosen to create a particular remedy for a particular injury in no way precludes the Congress from creating an additional form of relief for another injury. Thus, the fact that a shareholder claiming fraud both in the consummation of a merger not based on any justifiable corporate purpose and in the undervaluation of his shares may under state law only resort to an appraisal proceeding that merely ameliorates the undervaluation does not foreclose the right of the Congress and the federal courts to provide that claimant an additional right and remedy to redress any injury flowing from a fraud inherent in the merger itself.

Second. Another erroneous assumption is that in order to allege a claim under Rule 10b-5 there must be some showing of misrepresentation or lack of disclosure. This, is one of the grounds stated by Judge Brieant in the court below for his dismissal of the complaint. 391 F.Supp. 849, 854-55. But only subdivision (2) of 10b-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud

other than and in addition to a failure to disclose or truthfully represent is also actionable:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> * * *
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

It must be that the failure to observe this broader scope of Rule 10b-5 led the court below to dismiss the complaint, even accepting "plaintiffs' claimed valuation" and assuming the truth of the allegations of the complaint to the effect that the stock was grossly undervalued and that there was no justifiable corporate reason for the merger. Our later review of the decisions of this Court on the subject of allegations under Rule 10b-5 of breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure will, we think, demonstrate that in such cases misrepresentation or lack of disclosure are not essential ingredients of the claim for relief by the minority. But, lest there be any lingering doubt on this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary.

As with other laws Rule 10b-5 must be interpreted and applied so as to accomplish the purpose for which it was intended. That this requires a generous reading is too obvious for comment. Since the time to which the memory of man runneth not to the contrary the human animal has

been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the ordinary run of those willing and able to take unfair advantage of others are mere apprentices in the art when compared with the manipulations thought up by those connected in one way or another with transactions in securities. This is especially true of schemes that seem to be absolutely safe but offer rich rewards. In these days when there are takeovers and tender offers galore, times when those who used to think of going public now think of becoming private again, it is especially important to give Rule 10b-5 its full scope. If this is to be done, the enforcement of the fiduciary duty owed by the majority to the minority in corporations large and small should not be overlooked.

At this stage of the proceedings in this case we need not concern ourselves with the federal rules to be formulated relative to the ascertainment of the true value of the shares now held by the minority nor the specific remedy to be applied should the plaintiffs prevail.

We also recognize that we are only dealing now with the allegations of the complaint, which we must assume to be true. The defendants may prove that there has been no breach of fiduciary duty by the majority. More of this later.

Without further discussion we think it is clear that the case relates to the purchase and sale of securities in interstate commerce,[3] that the plaintiffs are indeed forced sellers,[4] and that there is a causal relation between the alleged breach of fiduciary duty by the majority and the injury suffered by the complaining owners of the minority stock interest.

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[3] *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 634 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Popkin* v. *Bishop,* 464 F.2d 714, 718 n. 8 (2d Cir. 1972).

[4] *Vine* v. *Beneficial Finance Co., supra,* at 635.

II

Prior to July 31, 1974, plaintiffs were minority shareholders of Kirby Lumber Co., a Delaware corporation. For some years prior to the merger transactions involved here, approximately 95% of the capital stock of Kirby was owned by defendants Santa Fe Natural Resources ("Resources") which in turn is a wholly-owned subsidiary of defendant Santa Fe Industries, Inc. ("Santa Fe").

In July, 1974, Resources embarked upon a plan to effect a short-form merger pursuant to Section 253 of the Delaware Corporation Law, which permits a parent corporation owning at least 90% of the capital stock of a subsidiary to merge the parent and the subsidiary, upon approval by the parent's Board of Directors and shareholders. Accordingly, a fourth corporation, Forest Products, Inc. ("Forest Products"), was organized in July as a Delaware corporation. Resources transferred approximately 95% of the capital stock to Forest Products, together with cash and the assumption of certain liabilities, in exchange for all of Forest Product's capital stock.

Shortly thereafter, the board of Forest Products adopted a Section 253 merger resolution providing that Forest Products would be merged into Kirby, with Kirby as the surviving corporation. Since such a merger resolution may provide that all shares held by minority shareholders will be purchased for cash, and consent of the minority shareholders is not required, the resolution stipulated that the minority shareholders of Kirby would have the right to receive $150 per share or to seek appraisal for their stock, as permitted by the Delaware statute. The merger became effective on July 31, 1974. In accord with Delaware Corporation Law Section 253(b), "new" Kirby notified the shareholders of "old" Kirby of the merger and of their rights, and sent a detailed financial Information Statement regarding Kirby.

None of the plaintiffs tendered any of the stock of Kirby. Instead, on August 21, 1974, they made a demand for appraisal of their Kirby stock. On September 9 of that same year, however, they purported to withdraw that demand, and on September 10, they commenced this lawsuit.

The gravamen of their complaint, in which the prayer for relief is that the merger be rescinded, that plaintiffs be awarded money damages or such other and further relief as may be just, is that the short-form merger resulted in the acquisition of the minority shares at a "grossly undervalued price." That undervaluation, they claim, combined with the corporation's failure to disclose the merger to plaintiffs until after its completion, and the fact that, as they say, the merger was effected without any business purpose, constituted a manipulative and deceptive device in breach of Rule 10b-5 and a common law breach of the fiduciary duty owed to Kirby and its minority shareholders. Since an opinion from Appraisal Associates, contained in the Information Statement sent to plaintiffs, valued Kirby's land and timber at $320 million, plaintiffs contend that the appraisal of the minority shares should have been at least equal to $772 per share. The statement to the minority shareholders presented the alternative of cash amounting to $150 per share or a valuation by the courts if requested. The $150 per share was based upon the opinion of Morgan Stanley & Co. which concluded:

> Based on our studies as outlined above, and on the assumptions that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

This opinion was expressed in a letter of June 24, 1974, which in turn was based upon a detailed study of the business affairs of Kirby Lumber Corporation, including a review of financial statements and appraisals of the Company's properties as set forth in elaborate schedules attached to the Information Statement. All plaintiffs' claims with respect to the alleged "fraudulent" and "unconscionable" undervaluation of the stock are based upon what was thus disclosed to the shareholders prior to the merger in the Information Statement.

III

The Law

A

The Delaware Corporation Laws

Many years ago the State of Delaware through its legislature established a series of corporation laws thought to be favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the members of the legal profession located in Delaware. Many of these laws were copied in other states for similar purposes. Without making a long story of it, some of these laws were intended to facilitate the squeezing out of minority shareholders. Of these laws, the one with which we are principally concerned here made elaborate provisions for a short-form merger under Section 253 of the Delaware Corporation Law. The salient feature of this short-form merger was that a majority of 90% of the shareholders could eliminate the 10% minority without any vote of the shareholders, without prior notice to the minority shareholders, without any statement of

corporate purpose and by fixing an amount to be paid per share to the minority shareholders, who were given the option of selling their shares at the stipulated price or demanding an appraisal under the auspices of the Delaware Court of Chancery, pursuant to the terms of Section 262 of the Delaware Corporation Law. We are told that the avowed purpose of these laws was to wipe out the minority.[5] The Delaware courts have held that the sole remedy of the minority shareholders is to demand the appraisal and be paid the amount per share fixed by the appraisal.[6] No opportunity is afforded the minority shareholder in advance of the date when the merger becomes effective to apply to any court for injunctive relief to stop the merger, nor is there any provision for rescission or other relief.

The Delaware laws also permit a long-form merger in cases where the majority have control but not 90% of the stock. In such cases prior notice is required and an opportunity is afforded to apply to a court for injunctive relief. In this class of mergers a vote of the shareholders is necessary.

In the case of a short-form merger, if the majority decides to fix the price to be paid to the minority shareholders at a figure substantially less than the shares are worth and the merger becomes effective and the minority shareholders turn in their stock and receive from the corporation the amount stipulated to be paid, all in the absence of any stated corporate purpose, the corporation pays for the stock bought from the minority shareholders, the minority shareholders are squeezed out and the entire

[5] See *Stauffer* v. *Standard Brands Inc.*, 40 Del. Ch. 202, 178 A.2d 311, 314 (Ch. 1962), *aff'd*, 41 Del. Ch. 7, 187 A.2d 78 (Sup. Ct. 1962).

[6] See note 1 *supra*.

benefit of the transaction inures to the majority shareholders. The corporation receives no advantage, and may in fact suffer detriment, and by the elimination of the shares of stock of the minority the majority's shares become more valuable. Plaintiffs claim this is just such a case.

B

Where a Breach of Fiduciary Duty by Majority Shareholders with Resulting Detriment to the Minority Is Alleged as in this Case, No Claim of Misrepresentation or Lack of Disclosure Is Required to Make Out a Case Under Rule 10b-5

The main thrust of the decision below is that to state a preliminary case under Rule 10b-5 there must be misrepresentation or lack of disclosure even in the presence of a breach of fiduciary duty. We disagree. While the "fraud" at which 10b-5 is aimed obviously includes the classic examples of misrepresentation and nondisclosure inveighed against in *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964) and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), it is by no means limited to that type of illegality. As the Court stated in *S.E.C.* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963), quoting from *Moore* v. *Crawford*, 130 U.S. 122, 128 (1888):

> Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.

The Court has previously made clear that Section 10(b) was not intended to be a panacea for all corporate ills and management wrongdoing, *Superintendent of Ins.* v. *Bankers Life and Casualty Co.*, 404 U.S. 6, 11-12 (1971). But

it has also directed that "[s]ection 10(b) must be read flexibly, not technically and restrictively." *Id.*, at 12. *See also A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 396-7 (2d Cir. 1967). We have followed that mandate.

In *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 (1969), we focused on the question whether improper self-dealing and breach of fiduciary duty by the majority, without more, constituted a violation of 10b-5. Answering that question in the affirmative, Judge Hays, writing for the majority, emphasized subdivision (3) of 10b-5 and held that a preliminary cause of action under that Rule had been stated. Breach of fiduciary duty and fraud on the *cestuis* and the corporation had been committed, on the facts as alleged, when Banff sold its shares to Aquitaine at an inordinately low price after the directors had learned of the important oil discovery and before that information had been made public, even though there had been neither misrepresentation nor failure to make any required disclosure to the minority. The decision echoes the well-established principles enunciated in *Pepper* v. *Litton*, 308 U.S. 295, 306-7 (1939), that directors and controlling shareholders are fiduciaries.

> Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

Id., at 306. When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders' interest for the sole purpose of feeding the pocketbooks of the controlling shareholders,

such conduct goes beyond mere negligent mismanagement and is properly cognizable as "an act, practice, or course of business which operates or would operate as a fraud * * *." The majority has abused its equitable powers by exercising them for the "aggrandizement, preference, or advantage of the fiduciary to the exclusion of the *cestuis*." *Pepper* v. *Litton, supra*, at 311. *See also Drachman* v. *Harvey*, 453 F.2d 722, 736 (2d Cir. 1972) (*en banc*).

Our finding of fraud inherent in the freezing out of a splinter interest in the context of a "going private" transaction that lacks corporate purpose is not without scholarly or judicial support. *See, e.g., Bryan* v. *Brock & Blevins Co., Inc.*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974); *Voege* v. *American Sumatra Tobacco Corp.*, 241 F.Supp. 369, 375 (D. Del. 1965) ("Plaintiff at bar was the subject of deception for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find, according to the complaint, that the terms of the merger were designed to defraud her."); Borden, *Going Private—Old Tort, New Tort, or No Tort?* 49 N.Y.U. L. Rev. 987 (1974); Note, *Going Private*, 84 Yale L. J. 903 (1975); Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 Harv. L. Rev. 1189 (1964).

Most recently in *Marshel* v. *AFW Fabric Corp.*, —— F.2d ——, Dkt. No. 75-7404 (2d Cir. February 13, 1976), we were faced with the question whether a merger lacking any justifiable corporate purpose and effected under the New York long-form merger statute might be challenged by minority shareholders under Rule 10b-5. Notwithstanding the absence of any allegation of misrepresentation or nondisclosure, we granted the shareholders' motion for a preliminary injunction against the proposed merger and held that a cause of action under Section 10(b) and Rule 10b-5 is stated "when controlling stockholders and direc-

tors of a publicly held corporation cause it to expend corporate funds, to force elimination of minority stockholders' equity participation for reasons not benefiting the corporation but rather serving only the interests of the controlling stockholders * * *." Like the Delaware provisions, the New York merger statutes provide an appraisal remedy for the complaining minority shareholders. In addition, however, since prior shareholder approval is required in the instance of the long-form merger, the shareholders in *Marshel* were also afforded the opportunity to seek premerger injunctive relief. We regard the unavailability of this additional remedy in the case before us as further justification for the intervention of the federal courts to remedy any fraudulent conduct.

We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. We do not hold that the charge of excessively low valuation by itself satisfies the requirements of Rule 10b-5 because that is not the case before us.

C

Popkin v. *Bishop, 464 F. 2d 714 (2d Cir. 1972) Is Distinguishable and the Ruling in that Case Impliedly Supports Our Decision in this Case*

Curiously enough both sides in the case before us rely upon *Popkin* as controlling. That was a long-form merger

case under the New York counterpart of the Delaware long-form merger law. There was no basis for a short-form merger as the majority control was 51.7%, far less than the 90% required for a short-form merger. Accordingly, prior shareholder approval of the merger was required and the minority interest was given an opportunity, prior to the consummation of the merger, to sue for injunctive relief to stop the merger. There was no showing of misrepresentation or lack of disclosure and, accordingly, the complaint was dismissed. The principal feature of *Popkin* that distinguishes it from the case before us is that in *Popkin* there was a corporate business purpose so strong as to be as a practical matter compelling. This purpose arose from a stipulation made in a prior New York state suit one of the principal terms of which was that the merger be consummated, evidently for the purpose of avoiding the possibility of future management misconduct. (464 F.2d at 716). Thus the court held that plaintiffs in *Popkin* had no Rule 10b-5 claim.

The reasoning of *Popkin* also supports the conclusion we reach here to the effect that the allegation of breach of fiduciary duty owing by the majority to the minority states a 10b-5 violation without a showing of misrepresentation or lack of disclosure. *Popkin* holds that the primary reason misrepresentation or lack of disclosure was required was that shareholder approval was necessary. "In the context of such transactions [*i.e.*, those for which shareholder approval is required], if federal law insures that shareholder approval is fairly sought and fully given, the principal federal interest is at an end." 464 F.2d at 720 [material supplied]. The plain implication is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresenta-

tion or lack of disclosure to make out a 10b-5 case. As the *Popkin* court stated,

> In many, if not most, corporate self-dealing transactions touching securities, state law does not demand prior shareholder approval. In those situations, it makes sense to concentrate on the impropriety of the conduct itself rather than on the "failure to disclose" it because full and fair disclosure in a real sense will rarely occur.

464 F.2d at 719. Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constitute the fraud, and not whether or not the majority determines to lay bare their real motives. If there is no valid corporate purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct. This is the substance of plaintiffs' reliance on *Popkin* here, and we agree.

It may well be that, in view of the fact that the majority's 51.7% control made it inevitable that minority opposition would be futile, any requirement of misrepresentation or lack of disclosure was illusory. Whether or not this criticism of *Popkin* is justified is, we think, for another day.

IV

The Allegations of the Amended Complaint Fail to State a Claim under Rule 10b-5 Against Morgan Stanley & Co.[7]

[7] Of course, the separate position of Morgan Stanley & Co. was not even discussed by Judge Brieant in his opinion as he held that no Rule 10b-5 case had been alleged against any of the defendants because of the absence of any allegation of misrepresentation or lack of disclosure.

As we have already said, we do not now hold that an allegation of substantial undervaluation, standing alone, makes out a Rule 10b-5 case in a Delaware short-form merger setting. We deal here with the additional elements of lack of a justifiable corporate purpose for the merger and the fact that the Delaware law provides for no prior notice to the minority shareholders thus depriving them of the opportunity to apply for injunctive relief, as well as the allegations of undervaluation. Morgan Stanley & Co.'s involvement in the merger was strictly limited to the valuation of stock and to the compilation of a report detailing the company's financial status. There is no allegation that Morgan Stanley & Co. engaged in any misrepresentation or nondisclosure such as would support its liability under Rule 10b-5(2).

We find no intimation in the amended complaint or in any of the briefs that Morgan Stanley & Co. had anything whatever to do with the planning of the merger or that it had any knowledge as to whether or not there existed a justifiable corporate purpose for the merger. And, of course, Morgan Stanley & Co. cannot be, and has not been, charged with any responsibility for effectuating the procedural steps incidental to the merger or for implementing the Delaware law and its provision for shareholder notice only after the merger has become effective. Most importantly, Morgan Stanley & Co. has not been charged with participation in the majority shareholders' breach of fiduciary duty, a key element of the latter's 10b-5 liability.

Even with respect to the alleged undervaluation of the stock we think the conclusory allegations that Morgan Stanley & Co. acted willfully, as an accessory and as an aider and abettor in setting the value of the Kirby shares are plainly insufficient. The Information Statement itself, including the Morgan Stanley letter of June 24, 1974, and the Schedules and Exhibits attached to these documents,

shows on its face that there was no wilful or other representation by Morgan Stanley & Co. that the Kirby shares should be valued at $150. All that Morgan Stanley & Co. did, or was asked to do, was to assemble and present for the consideration of the Kirby management and the minority shareholders the data and information, including the price at which the shares would probably be publicly or privately traded, which would enable the minority shareholders to make an intelligent decision as to whether to surrender their stock in return for $150 a share or apply to the Delaware Court of Chancery for an independent valuation of the stock. It is not even alleged that Morgan Stanley & Co. had anything to do with the decision by the majority shareholders to fix the offering price at $150 a share, thereby adding an increment of $25 to the fair market value as appraised by Morgan Stanley & Co., perhaps in the interest of leading the minority shareholders to believe that the offer was a generous one. Finally, it is not alleged that Morgan Stanley & Co. received any benefit or unjustly profited in any direct or indirect manner by its appraisal.

A copy of the letter of Morgan Stanley & Co. of June 24, 1974, is set forth in the margin.[8] We think the reference to "fair market value" in the first paragraph as well as the entire last paragraph of the letter is to current sales of shares of Kirby stock on some stock exchange, or otherwise, a subject in which the minority shareholders might be expected to be interested. The record is barren of any

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[8] Morgan Stanley & Co.
1251 Avenue of the Americas
New York, N.Y. 10020

June 24, 1974

Mr. John C. Davis
Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604
Dear Mr. Davis:

You have asked that we furnish an opinion as to the present fair market value of a share of capital stock of Kirby

(footnote continued on the following page)

(footnote continued from preceding page)

Lumber Corporation ("Kirby" or the "Company"), a subsidiary of Sante Fe Natural Resources, Inc. We understand that 25,324.5 shares or approximately 5.1% of the Company's outstanding capital stock constitutes the minority interest.

In connection with our study of the Company for purposes of making our valuation, we have toured the Company's facilities and have had discussions with management regarding the Company's business. We have been furnished with and have reviewed the Company's audited financial statements for the five years ended December 31, 1973, and the unaudited financial statements for the four-month period ending April 30, 1974. We have reviewed the Company's five-year forecast for the years 1974-1978 and have discussed it and the general future outlook for the Company with its management. Also, we have reviewed the written appraisals of the Company's properties and mineral rights which were separately performed by Appraisal Associates and Riggs and Associates.

We have studied the Company's financial position and its operating history and have made comparisons of such information with the financial position and operating histories of other companies in the forest products industry, the securities of which are publicly held and actively traded.

We have, in addition, considered such other matters and made such other studies as we considered necessary or pertinent.

Based on our studies as outlined above, and on the assumption that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

Very truly yours,
/s/ Morgan Stanley & Co.

information on the subject of public or private trading in shares of this publicly owned stock. Nor do any dates of purchase and sale transactions appear in the record, except certain purchases by affiliates at prices ranging from $65 per share in 1968 to $90 per share in 1973 in one of the Exhibits attached to the Information Statement. We are inclined to suspect, in the absence of any statement on this point in the complaint or in the briefs, that the reason for the estimate by Morgan Stanley & Co. was that there was no public or private market for the stock.

Thus, absent any claim that Morgan Stanley & Co. was in any way involved in planning or effectuating the merger, or that it shared in the alleged profiteering and faithless conduct of the majority shareholders, appellants' summary allegations that the Company participated in fraudulently undervaluing the minority shares fails to state a claim under Rule 10b-5.

V

Conclusion

The provisions of the Delaware corporation law relative to short-form mergers have been the subject of favorable and unfavorable comment for years. One of the Commissioners of the SEC has made a speech on the subject. The SEC has circulated certain proposed new rules.[9] Law professors, practicing lawyers and student editors of law

[9] Proposed Rules 13e-3A and 13e-3B, 2 Fed.Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. The proposed rules would subject short-form mergers and other share repurchase transactions to comprehensive regulation. Significantly, the rules would require that the issuer have a valid corporate purpose for any repurchase of minority shares in connection with a short-form merger and that the terms of such a transaction, including any consideration to be paid to the minority shareholders, be fair.

reviews have had their say. We do not think it would be profitable to comment on any of this, except to say that we have read all this material and given it the consideration we think it deserves.

We have also refrained from comment on the remedy to be applied, in the event that plaintiffs succeed at the trial, or on the thorny subject of how in such event a proper valuation of the stock is to be made. These are questions proper for consideration at the trial level, after all the proofs are in. In view of the conclusions at which we have arrived, we do not reach the pendent or diversity claims.

With respect to defendant Morgan Stanley & Co. the order and judgment appealed from are affirmed. As to the other defendants the order and judgment appealed from are reversed.

Mansfield, *Circuit Judge* (Concurring):

I concur in Judge Medina's opinion holding that a short-form merger consummated without any legitimate corporate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5. By using the short-form merger device in this fashion the majority commits a wrong that extends beyond mere mismanagement of corporate affairs; the majority also breaches its duty as a fiduciary to deal fairly with the public investors, and, by acting unilaterally and without any advance notice, deprives them of the opportunity to seek relief based on the absence of any legitimate corporate purpose. The resulting merger amounts to a "manipulative or deceptive device or contrivance" which operates as a fraud on public stockholders of the type intended to be proscribed by § 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. Upon a showing that the merger had no legitimate corporate

purpose, the district court should, if feasible, set it aside or, if the merger cannot effectively be voided,[1] award damages representing the difference between the fair buy-out price and the unfair, unilateral buy-out price set by the corporate insiders.[2] Such relief is not barred by the co-availability of state law remedies. *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 12 (1971); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972).

Inherent in the act of "going private" through a short-form merger is an enormous potential for abuse of the corporate insiders' fiduciary position with respect to the "frozen out" public shareholders. Essentially, by "going public" when the stock market is flourishing and squeezing out the public shareholders when the market is depressed, the majority is able to manipulate the sale and purchase

[1] Ordinarily in providing relief a court faces difficulties in setting aside a consummated merger. However, in the case of a short-form merger, the sole functional difference between the pre- and post-merged entities is the absence of the "frozen-out" public shareholders from the latter. Therefore, unless the parties materially and in good faith had relied upon the merger, the court in equity should be able to undo the unlawful effects of the short-form device by restoring the public shareholders to their pro-rata share of ownership.

[2] As Judge Medina notes, for purposes of this appeal we are to assume that the $150 per share offered by Kirby to the public shareholders is inadequate and that the correct buy-out price equals $772 per share, a sum derived by a pro-rata division of Kirby's appraised assets. Should the district court decide that legal and not equitable relief is appropriate here, it, of course, would be required to determine a fair buy-out price, cf. *Knauff* v. *Utah Construction & Mining Co.,* 408 F.2d 958 (10th Cir.), *cert. denied,* 396 U.S. 831 (1969); *Levin* v. *Great Western Sugar Co.,* 406 F.2d 1112 (3d Cir.), *cert. denied,* 396 U.S. 848 (1969), in the same manner as damages ordinarily are ascertained in a Rule 10b-5 action.

of stock to its benefit and to the detriment of the public shareholders, depriving the latter involuntarily of their investment in the corporation, see Vorenberg, *Exclusiveness of the Dissenting Shareholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964), at a buy-out price unilaterally selected by the insiders, which they have every incentive to fix below the fair value of the public shareholders' interest. Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers,* 88 Harv. L. Rev. 297, 298 (1974).

The unfairness and conflicts of interests generated by "going-private" mergers have not been lost on the business community. For example, Dun's Review, January, 1975, at 37, reports:

> "However one looks at it 'going private' is most often a no-win situation for public shareholders. For the buy-out price is almost always a small fraction of what the investor paid for the stock. The price, moreover is determined by a consultant hired by the buyers. The investors have a choice of taking what is offered or holding a stock that is no longer readily marketable. And the insiders have formidable legal devices available to fight investors who refuse the company's offer.
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> * * * * *
>
> "Not only are the offering prices in buy-outs far below what they paid, investors claim, they often do not reflect the current financial strength of the company any more than the market price does." *Id.* at 38.

The Wall Street Journal, October 18, 1974, at 1, concurs, stating:

> "[a] move to go private ordinarily creates a conflict of interest . . . [as] controlling shareholders who directly or indirectly finance the move often are buying back their interests at only a fraction of the price at which they originally were sold to the public. . . ."

And Barron's, March 4, 1974, at 3, 13, warns:

> "Generally, it is the low price of the stock, rather than declining earnings which sends firms private. . . . Admittedly, there are times when it appears that stockholders have been had. Indeed, figures indicate that the ones benefiting most from buying back the stock are the people who sold it to the public in the first place."

In conclusion, Business Week, November 2, 1974, at 114, editorializes:

> "[T]here is a distinctly bad smell about a deal that produces a substantial loss for the majority of the shareholders and a fat profit for a tiny minority."

My purpose in referring to these current appraisals of the short-form merger device by those who have observed it in action is not to impugn the motives of the defendants in this case but to emphasize that the problem created by misuse of the short-form merger is not merely one of regulating "transactions which constitute no more than internal corporate mismanagement," *Superintendent of Insurance* v. *Bankers Life & Cas. Co., supra,* 404 U.S. at 12, but one of protecting the public investor against manipulative devices used to deceive him, and the securities market from devices serving to discredit it, which together form the primary functions of the anti-fraud and anti-manipulation privisions of Rule 10b-5. The short-form merger, when used to squeeze out small public investors by forcing them to relinquish their corporate investments at low prices for no purpose other than to benefit the insiders, can accurately be characterized as a "manipulative or deceptive device or contrivance," *id.* at 10, which interferes with the interests of the public shareholders in the most

fundamental of ways, by depriving the investor of his very interest in his corporate investment. It also undercuts the broader purpose of "preserving the integrity of the securities markets," *id.* at 12, for a clearer instance of potential abuse of the market processes cannot be found. Commenting on the use of the short-form merger, SEC Commissioner Sommer has stated:

> "What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to . . . the securities markets than he already is." ([1974-75] Fed. Sec. L. Rep. ¶ 80,010 at 84,695)

To immunize the short-form merger from the coverage of Rule 10b-5 merely because state law has authorized the device to be used for the purpose of squeezing out the public shareholders without giving them prior notice or an opportunity to obtain injunctive relief would be to ignore the central protective purposes underlying federal securities legislation and to countenance an anomalous result. Those who are most exposed and most vulnerable—the small outside public shareholders who are not privy to the inner workings of the corporate enterprise and who are forced to accept a unilaterally imposed result—would be the least protected. If they are to enjoy the protection intended to be furnished by 10b-5, that rule must not be interpreted in a technical or niggardly fashion.

When we were first called upon more than a decade ago to decide whether certain types of fraudulent corporate practices or devices fell within the proscriptions of Rule 10b-5, our initial tendency was to adhere rather closely to the elements of common law fraud (misrepresentation,

reliance, scienter) in interpreting Rule 10b-5. See, e.g., *O'Neill* v. *Maytag*, 339 F.2d 764, 768 (2d Cir. 1964). Moreover we considered it essential that the fraud, to be actionable under the rule, must be intrinsic to the securities transaction itself. See, e.g., *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970), *aff'g*, 300 F. Supp. 1083 (S.D.N.Y.), *rev'd*, 404 U.S. 6 (1971). Beginning in *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393 (2d Cir. 1967), and in *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (en banc) *cert. denied*, 395 U.S. 906 (1969), however, we recognized that the ambit of the term "fraud" was used in 10b-5 must be widened if Congress' objective—protection of the public investor—was to be achieved. Furthermore, since only section (2) of 10b-5 deals with misrepresentation and non-disclosure, a broader definition of fraud would give effect to the prohibitions of sections (1) (employment of "any device, scheme or artifice") and (3) (engaging in "any act, practice or course of business which operates . . . as a fraud"), which disclose a broad intent to prohibit other forms of fraud. Accordingly in *Schoenbaum* we broke new ground to the extent of holding that where there was improper self-dealing and abuse of fiduciary responsibility by majority shareholders, disclosure of material facts to interested insiders would not preclude public stockholders, who were not privy to the scheme, from holding the controlling wrongdoers liable under 10b-5 for treating the public investors unfairly, even though the technical niceties of common law fraud had not been met. See Folk, *Corporation Law Developments*, 56 Va. L. Rev. 755, 806-07 (1970).

The recognition that "fraud" as that term is used in § 10(b) must be interpreted broadly was given further impetus by the Supreme Court's decision in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*,

where, in holding that fraud forming the basis of a 10b-5 suit need not be intrinsic to the securities transaction itself, the unanimous Court stated that "Section 10(b) must be read flexibly, not technically or restrictively," 404 U.S. at 12. In line with this philosophy we, in *Drachman* v. *Harvey*, 453 F.2d 722 (2d Cir. 1972) (en banc), reconfirmed the stand taken in *Schoenbaum* and, in a suit by public investors, held corporate directors liable under 10b-5 for their conduct in calling back their corporation's convertible debentures at an excessive price in order to prevent conversion into common stock, which would have weakened the opportunity of a third party, with whom the directors were in conspiracy, to obtain control of the company. Judge Smith's dissent, later accepted by the court sitting en banc, did not place reliance upon evidence of misrepresentation or non-disclosure, but instead emphasized "that here the directors of Harvey, influenced by a conflict of interest and acting to support Martin's controlling interest," caused "the corporation [to] sustain . . . damage. . . ." This was considered sufficient to allege a Rule 10b-5 violation under the "broad and liberal reading" required by the rule. *Id.* at 735. More recently, in *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), in upholding 10b-5 liability we again de-emphasized the importance of alleged misrepresentations as "only one aspect" or "a part" of the illegal scheme that had at its core "market manipulation" and, as here, "a merger on preferential terms. . . ."

Defendants place heavy reliance upon *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1972), as representing a departure from our steady trend toward an expansive view of the reach of the federal security laws. However, to the extent that *Popkin* is at all relevant to the short-form merger context, it impliedly supports the application of the *Schoen-*

baum-Drachman rule to this case.[3] In *Popkin*, unlike the present case, *prior* stockholder approval of the proposed merger was required. Full *advance* disclosure of the relevant facts regarding the merger exchange ratios to the minority stockholders was effective protection because it gave them the opportunity, as Judge Feinberg noted, to seek state court injunctive relief which was purportedly available under Delaware law. *Id.* at 720. Here, in contrast, disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out. Indeed, it is well recognized that the state post-merger appraisal procedure does not provide an alternative remedy comparable to federal relief.[4] Only through liberal interpretation of

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[3] For support of this proposition in the literature, see Comment, *Schlick* v. *Penn-Dixie Cement Corp.: Fraudulent Mismanagement Independent of Misrepresentation or Nondisclosure Violates Rule 10b-5*, 63 Calif. L. Rev. 563, 570 (1975); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Management Cases*, 86 Harv. L. Rev. 1007, 1044 (1973); 47 N.Y.U.L. Rev. 1229, 1230 (1972).

[4] Under state law the only recourse available to the aggrieved shareholders is to initiate an appraisal proceeding, thereby hoping to be awarded the full value of their lost shares. In light of a variety of factors common to state appraisal laws, it is generally agreed that they provide an unrealistic remedy. See generally, Brudney, *A Note on "Going Private,"* 61 Va. L. Rev. 1019, 1023-25 (1975); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Take Overs*, 88 Harv. L. Rev. 297, 304-07 (1974); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 Calif. L. Rev. 1, 85 (1969); Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 Yale L.J. 223 (1962).

The Delaware statute is typical. The public shareholders are afforded no right to equitable relief under the statute and therefore are totally dependent upon the valuation figure settled upon by the

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appraiser. *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78 (1962). Yet in determining the value of the "frozen out" shares, the appraiser may not award the public shareholders any gain resulting from the merger itself or the expectation thereof. Under the terms of the statute, any payment must be "exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation." Del. Code Ann. tit. 8, § 262(b). This measuring criterion has been interpreted very stringently. For example, an appraiser may not award "an aliquot share in the value of the assets of the merged corporation." *Application of Delaware Racing Assoc.*, 213 A.2d 203, 209 (1965). The appraiser's focus must be entirely retrospective: "The determination must be based upon historical earnings rather than on the basis of prospective earnings." *Francis du Pont* v. *Universal City Studios*, 312 A.2d 344, 348 (Ch. 1973). In short, the controlling shareholders have every incentive to "freeze out" the outsiders since, even if the appraisal procedure functions perfectly, by the terms of the statute the insiders alone capture all of the prospective gains associated with the merger.

In addition, procedurally the Delaware appraisal route is far inferior to a federal cause of action in terms of protection for the minority shareholders. For example, unlike a federal class action Delaware explicitly bars those who actually initiate an appraisal from receiving compensation from non-active members of the class of displaced shareholders, even if the latter have expressed their disagreement with the merger terms and have asked to be included in the final recovery. *Raynor* v. *LTV Aerospace Co.*, 317 A.2d 43, 46 (Ch. 1974); *Levin* v. *Midland-Ross Co.*, 194 A.2d 853, 854 (Ch. 1963). The Delaware courts acknowledge that this inevitably creates a free-rider problem, see 317 A.2d at 46, which in turn insures that only a minority shareholder with a large bloc of shares will find it beneficial to seek an appraisal in the first instance. As Dun's Review, January 1975, at 64, notes: The proceeding takes years . . . and the investors do not even collect dividends while the appraisal is in the courts. Unless a shareholder has at least 20,000 shares, most attorneys believe it rarely pays off financially. . . ." Furthermore the statute expressly excludes the costs of attorneys or expert fees from the appraisal recovery. Tit. 8, § 262(h).

Finally, the extent of discovery rights available to displaced investors remains unclear. The statute provides that the appraiser

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10b-5 will the public investor gain the redress intended to be made available to him.

Our conclusion that where there has been self-dealing on the part of corporate insiders proof of misrepresentation or non-disclosure is not a *sine qua non* to the establishment of 10b-5 liability is shared by other Circuits. In ***Pappas*** v. *Moss,* 393 F.2d 865, 869 (3d Cir. 1968), Judge Seitz held "that where, as here, a board of directors is alleged to have caused their corporation to sell its stock to them and others at a fraudulently low price, a violation of Rule 10b-5 is asserted." The only deception found in the case, two misstatements in the shareholder resolution authorizing the sale, was of no practical consequence to the wrongdoing since shareholder ratification was unnecessary under state law and, in any event, was sought only after the sale was

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"may" examine any books and records of the corporation in question, § 262(e), but says nothing about the minority shareholders other than to insure them "a reasonable opportunity . . . to submit to him pertinent evidence on the value of the shares," § 262(e). In the past, when "frozen out" shareholders have attempted "to complicate the issue raised" by demanding "proceedings of an adversary nature," they have been repudiated. *Lichtman* v. *Recognition Equipment Inc.,* 295 A.2d 771, 772 (Ch. 1972) (claimant cannot introduce evidence of the value of stock options lost due to the merger). And while the outside shareholders therefore remain heavily dependent upon the corporation for information, Delaware law does not require disclosure of such information to shareholders even after the fact except for notice of the completed merger and a statement of the buy-out price. Tit. 8, § 253(d). As one commentator notes, "[t]he crucial valuation evidence—estimates of future earnings or of salable value of assets—is available to management but rarely to outsiders. Hence, these evidentiary problems which beset an outsider seeking appraisal or challenging for unfairness a merger which was timed by insiders make it a rare case in which he will succeed in establishing a value higher than was offered in the merger, in view of the leeway which courts allow to management's judgment." Brudney, *supra,* at 1024 n.21.

consummated. *Id.* at 867, 869. Similarly, the Fifth Circuit has repeatedly held corporate insiders liable under Rule 10b-5 in the absence of misrepresentation. For example, in *Rekant* v. *Desser,* 425 F.2d 872, 882 (5th Cir. 1970) (Wisdom, *J.*), the court wrote:

> "We conclude, therefore, that when officers and directors have defrauded a corporation by causing it to issue securities for grossly inadequate consideration to themselves or others in league with them or the one controlling them, the corporation has a federal cause of action under § 10(b). . . . The essence of the transaction is not significantly different from fraudulent misrepresentation perpetrated by one individual or another."

Similarly, in *Shell* v. *Hensley,* 430 F.2d 819, 826-27 (5th Cir. 1970) (Ainsworth, *J.*), citing *Schoenbaum,* the court held directors liable for scheming to sell control to another corporation. In response to the argument that there had been no deception of the corporation warranting 10b-5 liability, since the controlling directors had all the relevant information, the court responded that to so construe 10b-5 would be to permit "the basest sort of chicanery" and remove the "protection of the section and the rule merely because of the ease with which defendants victimized [the corporation]." See also *Bryan* v. *Brock & Blevins Co.,* 490 F.2d 563, 571 (5th Cir.), *cert. denied,* 419 U.S. 844 (1974); *Travis* v. *Anthes Imperial Ltd.,* 473 F.2d 515, 527 (8th Cir. 1973) (Rule 10b-5 liability found even though "[t]he essence of the plaintiffs' complaint . . . is that the defendants violated § 10(b) and Rule 10b-5 by engaging in self-dealing. . . . Here, as in *Sup't of Insurance,* the defendants' self-dealing was a violation of a fiduciary obligation to minority shareholders. . . .").

Defendants' efforts to reconcile these decisions by searching for some misrepresentation or non-disclosure ignores the court's plain language in each case and exalts form over substance. Such misrepresentations as may be found generally related to technical, trivial matters, having little or no relevance to the manipulative conduct giving rise to 10b-5 liability. Furthermore, in some of the cases the courts, in imposing § 10(b) liability, were quite explicit in acknowledging the absence of misrepresentation or openly minimizing its import to the illegal conduct under challenge.

Thus our decision today is not only consistent with the trend of our own case law on the subject of 10b-5 liability but with the line of authority developing in other Circuits. In holding that a short-form merger which lacks any legitimate corporate purpose may violate 10b-5 we of course do not foreclose use of the device for legitimate corporate purposes. Such a merger, for instance, might lawfully provide an acceptable method of enabling a corporation to achieve substantial savings in operating expenses or to dispose of an unprofitable business at a favorable price. However, where a short-form merger involving use of a dummy corporation appears to be used for no purpose other than to squeeze out minority public shareholders, as is alleged in this case, the burden is upon the corporate insiders to demonstrate the existence of a legitimate compelling corporate purpose.

MOORE, *Circuit Judge* (Dissenting):

I most strongly dissent from the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also,

in effect, comparable laws in an additional thirty-seven States.[1]

By their opinion, the majority has found a fraudulent scheme, and hence a violation of Rule 10b-5 where none exists. They have established an irrebutable presumption that use of the short-form merger law amounts to a fraud *per se*. They have added a clause to the Delaware statute —not placed there by the State's legislature—that a short-form merger must have a "justifiable corporate purpose". They have manufactured evil intent and attributed it to individuals who were merely following the lawful edicts of Delaware, to the point of characterizing as "full of cunning and guile", and "so sophisticated as almost to defy belief", corporate actions of the utmost simplicity and

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[1] The following States have short-form merger statutes (the percentage of the subsidiary's stock which must be owned by the parent appears in parenthesis after each State):

Nebraska (80%)	Oregon (90%)
• • •	Pennsylvania (90%)
Arkansas (90%)	Rhode Island (90%
Colorado (90%)	Tennessee (90%)
Connecticut (90%)	Texas (90%)
Delaware (90%)	Utah (90%)
Florida (90%)	Virginia (90%)
Georgia (90%)	West Virginia (90%)
Hawaii (90%)	Wisconsin (90%)
Iowa (90%)	• • •
Kansas (90%)	Indiana (95%)
Kentucky (90%)	Mississippi (95%)
Louisiana (90%)	Montana (95%)
Maine (90%)	New Mexico (95%)
Maryland (90%)	New York (95%)
Massachusetts (90%)	North Dakota (95%)
Michigan (90%)	South Carolina (95%)
Nevada (90%)	Vermont (95%)
New Jersey (90%)	Washington (95%)
Ohio (90%)	• • •

Illinois (99%)

patent reasonableness in today's economy and securities market.

My agreement with the majority starts and stops on the first page of its opinion. The case is "important, [and] interesting"; it is not "complicated". Although legal issues are frequently clothed in dark and light shades of gray, the case at bar is a study in the stark contrast of black and white. The majority's conjury in holding that this case presents a violation of Section 10b of the Securities and Exchange Act and Rule 10b-5 promulgated thereunder[2] is totally without factual anchor, and I cannot refrain at the outset from objecting to the fraility of their factual foundation, which is truly of the character of bricks without straw and an omission that warrants immediate correction.

I. The Facts

The facts are not in dispute, and should be stated for the record in their particulars.

The sovereign state of Delaware in its legislative wisdom enacted a statute, which gives to corporations chartered under its laws, the privilege of merging parent and subsidiary under strictly limited circumstances, namely, ownership by the parent of at least 90% (here approximately 95%) of the stock of a subsidiary. Delaware General Corporation Law (DCL) § 253. The statute provides for the payment of cash to the minority stockholders or, in the event that any such stockholder is dissatisfied with the cash offer, he may seek an appraisal in the Delaware Court of Chancery to establish the stock's value. DCL §§ 253(d),

[2] Section 10b prohibits only those manipulative or deceptive devices "in contravention of such rules and regulations as the Commission may prescribe". A condition precedent to a violation of Section 10b is therefore the violation of the appropriate SEC rule, namely, 10b-5. *See* n. 4, *infra.*

262. In any such proceeding the stockholder would be able to adduce whatever proof he might believe to be supportive of his theory of true value.

The statute, referred to as the "short-form" merger proceeding, contains no provision for advance notice of the merger to be given to the minority (10% or less); only approval by the parent's directors and stockholders is required. Notice of the merger, however, has to be given within 10 days of its effective date, and within 50 days thereafter (following an initial demand within 20 days on the surviving corporation) appraisal, if desired, must be sought. DCL § 253(d).

Prior to the merger at issue, some 95% of the stock of Kirby Lumber Corporation (Kirby) was owned by Santa Fe Natural Resources, Inc. (Resources) which in turn is wholly-owned by Santa Fe Industries, Inc. (Santa Fe).

Plaintiffs are in the 5% (approximately) minority group of Kirby.

To take advantage of § 253 of the Delaware Corporation Law another Delaware corporation, Forest Products, Inc. (FPI) was organized which acquired from Resources its Kirby stock (95%) and on July 31, 1974 Kirby and FPI were merged.

Some time prior to the merger (February 19, 1974) defendants[3] had obtained from Appraisal Associates a written appraisal of the land (exclusive of minerals), timber, buildings and machinery of Kirby as having a market value of $320,000,000. Such an appraisal of physical assets mathematically would have amounted to a book value of the outstanding shares of Kirby of $722.

Subsequently, defendants, seeking a fair market value appraisal of the Kirby stock as of June 24, 1974, obtained from Morgan Stanley & Co. a stock valuation of $125 per

[3] Defendants, unless otherwise specified, will refer to the Santa Fe defendants, excluding Morgan Stanley & Co.

share. This figure was given with knowledge of Appraisal Associates' valuation of Kirby's physical assets of $320,000,000.

After the merger, as provided by Delaware law, DCL § 253(b), namely, "within 10 days after the effective date of the merger", notice of the merger was given to the minority stockholders that they had a right to receive $150 per share in cash or to seek an appraisal of the value of their shares as provided by Delaware law. DCL § 253(d).

Accompanying the notice was a statement (some 57 pages of the Appendix) which, in addition to setting forth extensive financial data, included: (1) the Morgan Stanley stock value based largely upon the price ranges for the Kirby stock freely traded on the market; (2) the Appraisal Associates' appraisal of physical assets of $320,000,000; and (3) an appraisal by Riggs and Associates of Kirby's oil, gas and mineral property interests.

On August 21, 1974 plaintiffs elected to pursue the Delaware law remedy of demanding an appraisal. Thereafter, they changed their minds and on September 9, 1974 withdrew this demand. The next day they filed their complaint in the federal court seeking to bring their claim within Section 10b of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5, 17 C.F.R. 240, 10b-5. Their original complaint was based primarily on the claim that defendants sought to acquire the minority's stock at a "grossly undervalued price" which constituted in plaintiffs' opinion a "manipulative and deceptive device" amounting to a violation of Rule 10b-5 and "a breach of fiduciary obligation owed to Kirby and its minority stockholders." (Compl. par. 9) An amended complaint added a claim of diversity jurisdiction over the defendants.

At this point it is essential to underscore what was *not* involved in the merger. There was no failure to comply with state law. There was no failure to disclose by the

defendants. On the contrary, all of plaintiffs' assertions of stock value derived from the report circulated by the defendants to the minority shareholders. Similarly, there was no misrepresentation of fact or law made to the minority.

II. Federal Law

The purpose of § 10b of the Act, and Rule 10b-5 promulgated thereunder, is the elimination of fraudulent practices in the securities industry. These are anti-fraud provisions, and the existence of fraud is the key to their application.[4]

It states the obvious to say that the essence of fraud is deliberate deception or concealment which is calculated to deprive the victim of some right or to obtain, by deceptive means, an impermissible advantage over him.[5] It was to

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[4] Rule 10b-5, which gives exclusive effect to Section 10b, is entitled "Employment of manipulative and deceptive devices", and declares it to be unlawful for any person,

> "(a) To employ any *device, scheme, or artifice to defraud,*
>
> (b) To *make any untrue statement* of a material fact or to *omit to state a material fact* necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any *act, practice, or course of business which operates or would operate as a fraud or deceit* upon any person,
>
> in connection with the purchase or sale of any security." (emphasis added)

Subsection (b) is inapplicable here because no claim is made that there were any untrue statements or omissions in the vast amount of information given to the minority stockholders. Plaintiffs' claims must, therefore, rest upon defendants' use of the Delaware statute as a "device * * * to defraud" (subsection (a)) or an "act * * * which [operated] as a fraud or deceit * * *."

[5] *See, e.g., Black's Law Dictionary* (4th Ed. 1951) at 788-789; *Ballentine's Law Dictionary* (3d Ed. 1969) at 496-497.

eliminate such deception and concealment that the federal securities laws imposed a duty to disclose on those with inside information. Similarly, it has been to eliminate deception and concealment, *i.e.*, to eliminate *fraud,* that the courts have stringently enforced this duty, imposing liability whenever a defendant fails to disclose his actions, his position, or his knowledge.

The majority cites numerous cases en route to its holding that failure to disclose is no longer a prerequisite for liability under Rule 10b-5—that, in fact, liability under the anti-fraud provisions of 10b-5 will attach in the *complete absence* of any deception or misrepresentation, in short, in the complete absence of fraud altogether. This is an untenable hypothesis, and one which is totally disproved by even a cursory review of the decisions in the area. I propose to review the leading cases in order to dispel at once any rumors that 10b-5 no longer concerns itself with fraud, but instead extends to every corporate transaction viewed with displeasure by the courts.

In 1964 in *Ruckle* v. *Roto Amer. Corp.,* 339 F.2d 24 (2d Cir. 1964), the directors of the corporation approved the issuance of stock to its president for an inadequate consideration. It was alleged that information material to the exercise of informed judgment had been withheld from the directors—a clear instance of fraud.

The same year this Court decided *O'Neill* v. *Maytag,* 339 F.2d 764 (2d Cir. 1964), in which we said: "There can be no serious claim of deceit, withheld information or misstatement of material fact in this case"; the opinion went on to say that, where a complaint alleges a breach of the general fiduciary duty existing among corporate officers, directors and shareholders, "no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to deception." 339 F.2d at 767, 768

SEC v. *Capital Gains Research Bureau,* 375 U.S. 180 (1964), is cited by the majority but in fact is more supportive of the dissent. *Capital Gains,* it should be noted at the outset, was not a 10b-5 case; it involved the unique duties and responsibility of investment advisors to their clients. The entire case was concerned with non-disclosure—specifically, with the failure of the defendant-investment advisor to apprise his clients of his self-interest in their transactions. The defendant's practice had been to buy a stock shortly before recommending it in a newsletter to his clients, and thereafter to sell it (usually within two weeks of the dissemination of the newsletter). The Supreme Court interpreted his legal and equitable duty *not* as a duty to refrain from trading himself (an act not prohibited by state law) but as a duty to disclose whatever interest he in fact had. It was not the existence of self-interest or of the defendant's action in furtherance thereof which went afoul of federal securities law; it was his *concealment* of those facts.

Three years later this Court decided *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967). Implicitly acknowledging the validity of short-form mergers,[a] the Court struck down a fraudulent sale of certain stock shares at an inflated price on the ground that the scheme presented "a classic case of deception". 374 F.2d at 635. Ruling on the applicability of the federal securities laws to corporate mergers, the Court held:

"What must be shown is that there was *deception*

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[a] "Thus, once the conditions for a short-form merger had been achieved, appellant's rights in his stock were frozen. *He had and still has only the options of exchanging his stock* for $3.29 a share, pursuant to appellee's offer, *or pursuing his right of appraisal,* which would also result in cash from appellee." 374 F.2d at 634. (emphasis supplied)

> which misled the Class A Stockholders. . . ." 374 F.2d at 635. (emphasis supplied)

In 1968 came *Schoenbaum* v. *Firstbrook,* 405 F.2d 215 (2d Cir. 1968), a case much relied upon by appellants, heard by an *en banc* Court. This case in many respects was a counterpart of *SEC* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2d Cir. 1968) (*en banc*). In *Schoenbaum,* Aquitaine, which controlled Banff Oil, had knowledge of an important oil discovery by Banff. Without disclosing this fact, Aquitaine caused Banff to issue to it 500,000 shares of Banff at $1.35 a share. After the public announcement of the discovery, Banff stock sold as high as $18 a share. There was more than sufficient indicia of fraudulent non-disclosure to justify denial of a summary judgment motion.

In 1971 the Supreme Court decided *Supt. of Insurance* v. *Bankers Life and Cas. Co.,* 404 U.S. 6 (1971), on appeal from this Circuit. The fraud there was most flagrant. One Begole and a group agreed to buy for themselves all of Manhattan Casualty Company's stock from Bankers Life for $5,000,000 and conspired with others to pay for the stock, not with their own funds but, once they had obtained the stock, out of Manhattan's own assets. A more fraudulent scheme would be difficult to imagine.

In 1972 came both *Drachman* v. *Harvey,* 453 F.2d 722 (2d Cir. 1972) (*en banc*) and *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972). The Court in *Drachman* found that as the result of a conspiracy, whereby the Harveys had sold their controlling interest in Harvey Aluminum to Martin Marietta at handsome premium for themselves and they had caused Harvey Aluminum to redeem its convertible bonds to preserve Martin Marietta's stock control of Harvey Aluminum, there was fraud within the scope of § 10-b and Rule 10b-5.

Popkin presented a somewhat different situation. It was largely to enjoin a merger on the ground that the exchange ratio of the respective stocks was unfair. This Court reviewed the many cases in this field, noting that "Emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases", 464 F.2d at 719, and concluding that "when there has been such disclosure of a merger's terms, it seems unwise to invoke federal injunctive power, particularly since doing so might well encourage resort to the federal courts by any shareholder dissatisfied with a corporate merger". *Id.* at 720. But, even assuming the federal courts are anxious to reach out for this sort of business, to do so at the cost of nullifying the corporate laws of many states respecting mergers of comparatively fractional amounts of outstanding stock should cause some restraint in enacting such judicial legislation.

Other circuits have found conspiracy and deception as basic in bringing cases within the statute and Rule. *See* *Dasho* v. *Susquehanna Corporation,* 380 F.2d 262 (7th Cir., 1967) and *Shell* v. *Hensley,* 430 F.2d 819 (5th Cir. 1970). And of particular interest because it was decided in a federal court in Delaware is *Voege* v. *American Sumatra Tobacco Corporation,* 241 F.Supp. 369 (U.S.D.C., Delaware, 1965). It, too, was a "merger" case. On the merger, $17 a share was offered; the plaintiff refused the offer and demanded an appraisal but, in so doing, did not know that as part of the merger it was planned to sell off a part of *Sumatra's* physical assets (land) which would alone bring in more than $17 a share. The Court, noting that the defendants—for purposes of their motion to dismiss—conceded that their misleading statements amounted to a scheme to defraud under Rule 10b-5, held that the plaintiff could be regarded as a "seller" within the meaning of the Rule. Appraisal was held to be an insufficient remedy

because of plaintiff's ignorance of the fraud at the time she demanded the appraisal. 241 F. Supp. at 375.

The District Court in this Circuit recently considered the permissibility of corporate mergers for purposes of enforcing federal securities law. In *Levine* v. *Biddle Sawyer,* 383 F.Supp. 618 (SDNY 1974), which involved a short-form merger, the Court denied defendant's motion for judgment on the pleadings on the ground that the facts presented a "scheme of deceit and concealment". 383 F. Supp. at 622.

Still more recently, in *Kaufman* v. *Lawrence,* 386 F. Supp. 12 (SDNY 1974), *aff'd per curiam,* Slip Op. at 2707 (4/3/75), the District Court refused to grant a preliminary injunction to halt a long-form corporate merger on the grounds that material omission had not been shown, and that the case was not one involving "any hidden or secret action by an outside group to take over control of the company". 386 F. Supp. at 17. The Court concluded pertinently:

> While Sections 10(b) and 14(e) must be read flexibly, and not technically or restrictively, * * * there is nothing invalid *per se* in a corporate effort to free itself from federal regulations, provided the means and the methods used to effectuate that objective are allowable under the law. Nor has the federal securities law placed profit-making or shrewd business tactics designed to benefit insiders, without more, beyond the pale. Those laws in respect of their design and interpretive reach, as I understand them, include the provisions relied on here, and are satisfied if a full and fair disclosure is made, so that the decision of the holders of WRG stock to accept or refuse the exchange offer can be said to have been freely based upon adequate information.

> A public company going "private" may indeed raise serious questions concerning protection of the public interest. There is, however, no foundation on the record before me from which the ramifications of that interest within the reach of the federal securities laws might conceivably be explored. . . . *Ibid.* (citations omitted)

Non-disclosure for purposes of deliberate concealment or misrepresentation is the essence of fraud, and synonymous with liability under Section 10b and Rule 10b-5. Against this setting the facts at bar are startling for the picture of unquestionable non-liability under Rule 10b-5 which they present. To reiterate, the defendants—pursuant to a duly enacted state law—effected a merger of a parent corporation and its 95%-owned subsidiary. This transaction is expressly sanctioned by statute, and all statutory requirements were complied with. Complete disclosure regarding valuation of shares was made. There was no attempt to hide the merger, or to misrepresent the minority's right to object and demand appraisal. On the contrary, the minority were expressly informed of their right to do so.

To conclude that this series of events presents a scenario of fraud is a patent distortion of that term. This case presents no claim of fraud at all, and appending the label of "fraud" to plaintiffs' complaint or the majority's opinion does not change the fact one iota. The facts adduced here are wholly unrelated to any cause of action under Section 10 and Rule 10b-5, and legal legerdemain cannot render them otherwise.

II. State Law

The majority concedes that when it speaks of fraud, it does not mean "fraud" at all, but rather a breach of fidu-

ciary duty. Majority opinion at 9, 16. Under the law, breach of fiduciary duty and commission of fraud are wholly different from one another, as was recognized by this Court in *O'Neill* v. *Maytag, supra,* at 339 F.2d 767:

> While the essence of these [fiduciary] duties in some circumstances is honest disclosure, the allegations in the instant case are typical of situations in which deception may be immaterial to a breach of duties imposed under common law principles.

The majority's insistence on extending federal securities anti-fraud provisions beyond the bounds of fraud and into the realms of fiduciary duty is disturbing enough. Accompanied, as it is, by their erroneous finding of a breach of such duty, and by the astonishing and impermissible establishment of a federal common law of corporations—as ill-founded as it is improper—disconcertion must give way to alarm.

There is no question that it is within the proper power of the State to enact statutes regulating corporation mergers. Corporations are creatures of the State. They are created under State law; they are empowered by State statute; and they are regulated by the legislative mandates of the State which has sanctioned their existence. Every State in the Union has comprehensive general business or corporation codes which attest to the exercise of the States' proper responsibilities over the formation of corporate entities and the regulation of corporate activities.

Exercising its unquestionable right to determine the statutory rights and duties of parent and subsidiary corporations chartered under its laws, Delaware has permitted subsidiaries to dispense with what would be the mere formality of a shareholder vote on merger in those circumstances in which the parent already owns an overwhelming

majority of the subsidiary's shares. Delaware law does *not* require that the merger be pursuant to any corporate purpose more limited than the general corporate purposes contained in the corporate charter, which set the boundaries beyond which the corporation will be said to act *ultra vires.* The short-form merger statute is not a procedure designed to effect certain business outcomes; it is the articulation of certain substantive rights which are given to majority and minority shareholders in the State of Delaware[7]—respecting the parent corporation, a right to expedite a merger which is already assured by the parent's overwhelming majority ownership of the subsidiary; respecting the minority, a protection "right to object and demand appraisal". *Coyne* v. *Park & Tilford Distillers Corp.,* 154 A.2d 893, 896 (Del. 1959).

The majority misses the point entirely when it comments as the justification for sidestepping Delaware law, that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law" (citing *Vine* v. *Beneficial Finance Co. supra*). Majority opinion at 6. "Cause of action" means "judicial remedy," not statutory right or compliance with state law, and the *Vine* Court stated the rule correctly when it held that

> [W]e do not regard the existence of a *state remedy* as negating the federal right. *Vine* v. *Beneficial Finance Co.,* 374 F.2d at 635-6 (emphasis supplied)

The substantive rights created by § 253 have been explicitly upheld as a valid regulation of Delaware corporations. The Delaware courts have also explicitly rejected the notion that the exercise of rights accorded by § 253 is

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[7] This was the Court's express holding in *Coyne* v. *Park & Tilford Distillers Corp.,* 154 A.2d 893 (Del. 1959).

itself a breach of duty or a perpetration of fraud. Focusing on the plaintiff's charges of fraud in connection with the statutory merger under § 253, the Supreme Court of Delaware ruled, in the leading case on the subject:

> The complaint, of course, contains allegations of oppressive treatment of the minority by the parent corporation, and a prayer that the merger be set aside. But it is plain that the real relief sought is the recovery of the monetary value of plaintiff's shares—relief for which the statutory appraisal provisions provided an adequate remedy. The Vice Chancellor held that in the circumstances of this case that remedy was exclusive. His analysis . . . was thorough and well-considered, and we agree with it. . . .
>
> [It is argued that] the appraisal remedy under our statutes should not be held to be exclusive.
>
> The answer to this is that the exception above quoted refers generally to all mergers, and is nothing but a reaffirmation of the ever-present power of equity to deal with illegality or fraud. But *it has no bearing here. No illegality or overreaching is shown. The dispute reduces to nothing but a difference of opinion as to value.* Indeed it is difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle the minority to set aside the merger. . . . *This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of a breach of trust against the directors of the [merged subsidiary]. . . . Stauffer* v. *Standard Brands, Inc.*, 187 A.2d 78, 80 (Del. 1962).[8] (emphasis supplied)

[8] *See also, Carl Marks & Co.* v. *Universal City Studios, Inc.*, 233 A.2d 63 (Del. 1967).

This holding accords with the Delaware common law respecting the equitable duty of fiduciaries which, like the statutory law of corporations, lies within the province of the States. Under Delaware law, it is not a *per se* breach of the duty owed the *cestui* for the fiduciary to deal in trust property; in other words, self-dealing is not, by definition, a prohibited activity. Where, for example, the fiduciary has certain already existing rights to acquire the property of the *cestui*, and where these rights are exercised openly and without deception, no violation of the trust results and a court of equity will not enjoin the acquisition.[9] On the contrary, where legal rights attend the parties to a fiduciary relationship, a court of equity will enforce those rights and will not permit a plaintiff to eschew legal rights and duties under the guise of invoking the court's equitable jurisdiction.[10] This is, of course, only an expression of the historic maxim and controlling principle that "Equity follows the law".[11]

To place the plaintiffs' allegations in this case into sharp focus, I would turn for a moment to plaintiffs' complaint. Emerging from plaintiffs' extravagant characterization of defendants' conduct as an "unconscionable self-deal" (3) a "FLAGRANT SELF-DEAL WHICH OPERATED AS A FRAUDULENT DEVICE", "a fraudulent overreaching" (16), an "unconscionable taking without compensation" (19) and a

[9] *See, e.g., In re Thomas*, 311 A.2d 112, 114 (Del. 1973); *Equitable Trust* v. *Gallagher*, 102 A.2d 538, 545 (Del. 1954).

[10] *See, In re Markel*, 254 A.2d 236 (Del. 1969); *Richard Paul, Inc.* v. *Union Improvement Co.*, 91 A.2d 49 (Del. 1952); *Wise* v. *Delaware Steeplechase & Race Ass'n.*, 45 A.2d 547 (Del. 1945).

[11] *See, generally*, 27 Am. Jur. 2d Equity §§ 118, 124; 30 C.J.S. Equity § 103; 13 Atlantic Rptr. Digest, Equity § 62; 30 A.L.R.2d 925; 9 A.L.R.2d 295.

"secret squeeze-out" (31),[12] plaintiffs' claims stand out in bold relief: (1) the merger was "Without any notice or disclosure whatsoever to the minority stockholders of Kirby" (Br. p. 4) and (2) the price of $150 offered was grossly below the $772 value of each share based on plaintiffs' theory of dividing the physical assets proportionately among the stockholders. It is on these grounds that the plaintiffs seek equitable intervention by the courts to effect a rescission of the merger.

As must be plain by this point, neither of plaintiffs' two claims warrants such relief. With respect to prior notice, plaintiffs were entitled to none by law—a not unreasonable provision in light of the fact that, under § 253, the 10% minority shareholder is entitled to fair value of his shares, and *not* to any opportunity to thwart the will of the overwhelming majority.[13] The parent corporation breached no fiduciary duty by exercising its statutory option to acquire the subsidiary without notice. The minority shareholders had no right to prevent such acquisition, or to challenge its legality on statutory grounds. Moreover, the minority shareholders had no right to demand from an equity court an affirmative right to notice in abrogation of the legal rights of the parent corporation, created by statute and recognized at common law and equity by the Delaware Courts.

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[12] It should be noted that all of these taken together are insufficient *as a matter of law* to satisfy the pleading requirements of F.R.C.P. 9(b) which mandates that allegations of fraud be supported by factual particulars.

[13] *See*, Borden, "Going Private—Old Tort, New Tort, or No Tort?", 49 N.Y.U.L.R. 987 (Dec. [illegible]4) (hereinafter "Borden") at 1031, n. 194, for an illuminating evaluation of minority shareholders' prerogative to overrule the majority's will in connection with corporate mergers.

With respect to the alleged undervaluation of plaintiffs' shares, Delaware law gives the dissenting shareholder a right to object, and affords him the legal remedy of appraisal. This is held to be both adequate and exclusive under § 253;[14] equitable relief, absent fraudulent deception or concealment, is unavailable.[15] It is important to stress that the discrepancy in claimed value of the Kirby stock does not *ipso facto* bespeak fraud. Although they refer to going concern value (but without supporting proof), plaintiffs' asserted value appears to be based on the assumption that the Kirby physical assets could be liquidated at the appraisal price and the proceeds divided up amongst the stockholders. However, there is nothing in the record to indicate that Kirby had any intention to liquidate and go out of business or that plaintiffs as holders of 143 shares had any power to compel liquidation. Moreover, under Delaware law a dissenting shareholder cannot recover in appraisal proceedings the "liquidation value" of his shares (*i.e.*, a sum equal to his aliquot share in the value of corporate assets); he is entitled only to "the intrinsic value of [his] shares determining on a *going concern* basis". *Application of Delaware Racing Ass'n.*, 213 A.2d 203, 209 (Del. 1965). (emphasis supplied)

By their complaint plaintiffs have utterly failed to assert any cognizable breach of fiduciary duty; any injury entitling them to equitable relief; any fact whatsoever indicating impermissible overreaching or deception by the defendants. There has been total compliance with state law, complete disclosure of valuation data, and total availability to plaintiffs of Delaware's appraisal procedures. Significantly, all of plaintiffs' assertions of stock value derive from the report circulated by the defendants to the minority shareholders.

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[14] *Stauffer* v. *Standard Brands Inc., supra*, at 187 A.2d 80.

[15] *Ibid.*

IV. The Majority's Holding

Notwithstanding all of the above, the majority has purported to find a violation of law that warrants equitable intercession. The majority's theory is that there was a breach of fiduciary duty to the minority because the merger did not have a "justifiable corporate purpose." This purported fiduciary standard is completely untenable; further comment on it will be made *infra*. First and foremost, however, the point must be made that, in taking cognizance of plaintiffs' claim, the majority has not provided a remedy to correct a fraud; rather it has extended to those plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity.[16] Indeed, the majority appears to have ignored the Supreme Court's decision in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1939), which put an end to federal common law and forbade the federal courts from formulating their own "better rule.'"[17]

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[16] When it is remembered that some three-quarters of the States have statutes similar to the Delaware short-form merger law, the magnitude of the majority's holding may be readily appreciated. *See* n. 1, *supra*.

[17] The Third Circuit, specifically referring to the law governing fiduciary duty, said as much in the well-known diversity suit of *Zahn* v. *Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir., 1947):

> "In our opinion . . . the law of Kentucky imposes upon the directors of a corporation or upon those who are in charge of its affairs . . . *the same fiduciary relationship* in respect to the corporation and to its stockholders *as is imposed generally by the laws of Kentucky's sister States or which was imposed by federal law prior to Erie R. Co.* v. *Tompkins.*" (citation omitted; emphasis supplied)

(footnote continued on the following page)

Reaching back to *Swift* v. *Tyson*, 16 Pet. 1 (1812), the majority has obviously rejected the valid state standards of Delaware defining fiduciary duty, and the valid state laws regulating the powers of state-created corporate bodies. The majority has tossed these off as so much *obiter dicta* and independently pursued a "better rule", altering the rights of parent corporations and minority shareholders in order to suit the majority's pleasure. The majority's use of the term "fraud" is no more than a smoke-screen; there is no factual foundation presented by the plaintiffs which indicates any fraud in this case. Moreover, under Delaware law, the short-form merger statute is part and parcel of the charter of every Delaware corporation, and of the contract between every such corporation and each of its shareholders.[18] The majority thus is redrafting corporate charters and private contracts at the same time as it is putting a torch to the teachings of *Erie*. In effect the majority has decided that equity will not follow the law, it will rewrite it.

(footnote continued from preceding page)

See, also, O'Neill v. *Maytag*, 339 F.2d 764, 767 (2d Cir. 1964), wherein we held that:

> "Between principal and agent and among corporate officers, directors and shareholders, *state law has created duties which exist independently of the sale of stock*. While the essence of these duties in some circumstances is honest disclosure, *the allegations in the instant case are typical of situations in which deception [under Rule 10b-5] may be immaterial to a breach of duties imposed under common law principles.*" (emphasis supplied)

That the federal courts' rules, in fact, may not necessarily be "better" is exemplified by the federal test for fiduciary duty adopted by the majority here. *See* this dissent, *infra* at pp. 1996-1999.

[18] *Voege* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965); *Greene* v. *Schenley Industries*, 281 A.2d 30, 35, 36 (Del. Ct. Ch. 1971).

Their choice for a federal fiduciary standard respecting corporations is the best possible indication of the error of the majority's holding. "Justifiable corporate purpose", as it is used in the majority opinion, is a totally amorphous standard which, although it is nowhere defined in the majority opinion, is nevertheless so inapposite as applied to short-form mergers that it cannot withstand even superficial scrutiny.

The short-form merger procedure permits a corporation to retreat from the public marketplace of securities trading and assume the status of a private company. "Going private", as the process has been popularly labeled, is being more and more frequently resorted to in today's recession economy. The benefits to a corporation are varied. Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of a long-term capital development or speculative capital investment—these are some of the advantages which may enure to a corporation "going private".[19] It is essential to underscore that *all* of the above-stated advantages accrue from the *very act of eliminating the 10% shareholders who confer public status on the corporation.* To say that such action is not a "valid business reason" (plaintiffs' complaint) or a "justifiable corporate purpose" (the majority holding) is to completely misapprehend the impact of the shift in status from publicly held corporation to private company. Benefit to the

[19] For an excellent discussion of the phenomenon and its impetus, *see* Borden at 1006-1018.

parent company is not incompatible with the notion of "justifiable corporate purpose"; it is a legitimate part of it. As one commentator has noted:

> The selfish motivation is often adverted to in connection with going private, but one wonders why that should be. Are only those corporate transactions to be favored which are not motivated by greed? Must we seek to do public good in order to avoid regulatory sanctions? The questions answer themselves. To observe that greed is a compelling motivation is merely to observe that we live in a free-enterprise society.[20]

It should be obvious that minority shareholders are as similarly motivated as the majority owners, and that their concern is not the purported damage to the public of "going private" transactions—the likelihood of which I seriously doubt—but rather, the equally selfish desire to avoid taking a loss while "playing the market". Such a desire, I submit, is a wholly inadequate justification for according to the 10% a veto power over the will of the 90%. Even our political system does not require 100% consensus before the majority will may be implemented; in fact, such a thought would be completely inimical to the values inherent in our democratic philosophy.

It should be recognized that, in a transaction such as the short-term merger at issue here, the parent corporation does not require any practical power or control over corporate management that it did not already have as a 90% owner. To the degree that the majority condemns "self-aggrandizement" as an effort to acquire control for self-benefit, then the merger *per se* results in no increased

[20] Borden, at 1043 (footnote omitted).

aggrandizement at all:

> If the evil in going private is perfecting or ensuring control, it would follow that there would be no wrong when the proponents of the transaction already have an impregnable hold on control. . . .[21]

Whatever "justifiable corporate purpose" may mean, it should be obvious from the above that, as utilized by the majority, it is a completely irrational concept that bears no reasonable relationship to the realities of short-form mergers in the actual business world.

I cannot believe that the majority has chosen to exceed the bounds of its jurisdiction under federal law in order to espouse so frail a concept, and I am more convinced than ever of the wisdom which the Supreme Court showed in compelling the federal judiciary to refrain from the business of rewriting state law by judicial fiat.

V. The Concurrence

Judge Mansfield in his concurring opinion falls into the same error as is so obvious in the majority opinion, namely, that "a short-form merger consummated without any legitimate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5." In short, any use of the Delaware statute is fraud *per se,* tantamount to a "device, scheme or artifice to defraud" and a course of business conduct that operates "as a fraud or deceit".

Particularly disturbing is the unfounded hypothesis that the merger was intended to take improper advantage of market conditions by the deliberate tender to plaintiffs of a grossly inadequate price for their shares. Plaintiffs themselves do not go so far by way of allegation.

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[21] *Ibid.* at 1031, n. 194.

Judge Mansfield in footnote 4 argues the inadequacy of an appraisal proceeding in fixing a fair market price and straightaway concludes that a federal court "would be required to determine a fair buy-out price"—the very determination which the Delaware law provides. On such a hearing the same items of proof would undoubtedly be offered: purchases and sales of Kirby stock by willing purchasers and sellers on or off public trading markets over a period of time; annual earnings per share in years good and bad; price/earnings ratios; projected earnings; and the physical asset value, as appraised, of $320,000,000.[22] The trial would have become a battle of experts, financial, accounting and physical property appraisers, but with the judicial system of Delaware available for this purpose it would not have lacked due process. Where there are disputes between parties as to fair values the courts not infrequently become the final arbiters, but the courts of the Second Circuit should not appropriate unto themselves the exclusive right and competence to engage in such determinations.

In summary, in my opinion, both majority and concurring opinions depart widely from the Congressional purpose in enacting Section 10b, from our own decisions thereunder and from the Supreme Court's interpretation thereof—thus far.

I would affirm the District Court's dismissal of plaintiffs' complaint.

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[22] Public financial information makes available the fact that many stocks publicly traded sell at prices only a fraction of their book value, whereas others sell at prices far in excess thereof

Memorandum of the Court of Appeals Denying the Petition for Rehearing En Banc.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the tenth day of March, one thousand nine hundred and seventy-six.

75-7256

S. WILLIAM GREEN, et al.,

Plaintiffs-Appellants,

v.

SANTA FE INDUSTRIES, INC., et al.,

Defendants-Appellees.

75-7404

ARNOLD MARSHEL,

Plaintiff-Appellant,

v.

AFW FABRIC CORPORATION, et al.,

Defendants-Appellees.

BARRY L. SWIFT,

Plaintiff-Appellant,

v.

CONCORD FABRICS, INCORPORATED, et al.,

Defendants-Appellees.

A poll of the judges in regular active service having been taken at the request of one of them, as to whether this action should be reheard en banc, and there being no majority in favor thereof, it is

Ordered that rehearing en banc is denied.

Chief Judge Kaufman and Circuit Judge Gurfein did not participate in the poll.

PER CURIAM:

This Court has denied en banc, not because we believe these cases are insignificant, but because they are of such extraordinary importance that we are confident the Supreme Court will accept these matters under its certiorari jurisdiction, as we correctly anticipated in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1020 (2d Cir. 1973), *vacated,* 417 U.S. 156 (1974).

Even under the best of circumstances, an en banc proceeding is often an unwieldy and cumbersome device generating little more than delay, costs, and continued uncertainty that can ill be afforded at a time of burgeoning calendars. A case in which Supreme Court resolution is inevitable should not be permitted to tarry in this Court for further intermediate action, at best, except when the views of this Court would be of real benefit to the Supreme Court. And, en banc is particularly inappropriate and un-

Memorandum of the Court of Appeals Denying the Petition for Rehearing En Banc.

satisfactory in the cases before us, since two of our active judges are disqualified from participating. With four senior judges sitting if these cases had been en banced, the law of the circuit might well be charted with the concurrence of only a minority of the active judges—defeating the very purpose the en banc procedure is designed to serve.

Moreover, the applications for certiorari that we expect inexorably to follow our action will not reach the Supreme Court devoid of the views of the judges of this Court. In contrast to the Pentagon Papers case—where this Court convened en banc but, due to urgent considerations of time, did not write opinions—these cases will go to the Supreme Court with full and thoughtful expositions of the opposing views of several members of this Court.

Accordingly, we speed these cases on their way to the Supreme Court as an exercise of sound, prudent, and resourceful judicial administration.

In the

Supreme Court of the United States

OCTOBER TERM 1975

No. 75-1753

Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc. and Kirby Lumber Corporation,

Petitioners,

against

S. William Green, *et al.*,

Respondents.

BRIEF IN OPPOSITION TO THE PETITION

Sidney Bender
Attorney for Respondents
405 Lexington Avenue
New York, New York 10017
Tel. No. (212) 986-4080

Of Counsel:

Aaron Lewittes

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In the

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OCTOBER TERM 1975

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Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc. and Kirby Lumber Corporation,

Petitioners,

against

S. William Green, *et al.*,

Respondents.

BRIEF IN OPPOSITION TO THE PETITION

Counterstatement of Question Presented

Is a sham merger, by which a fiduciary misappropriates 80% of its cestuis' property without their knowledge or consent, fraud and deceit within Rule 10b-5 under Section 10(b) of the Securities Exchange Act of 1934?*

* Presence of the other ingredients of a 10b-5 violation (purchase-sale of a security via mails and interstate commerce) is not contested.

Controlling Decisions of Supreme Court

The Court of Appeals decision against petitioners (collectively "Santa Fe"), the defendant fiduciary, is required by the decisions of the Supreme Court in *Supt. of Insur.* v. *Bankers Life,* 404 U.S. 6 (1971); *SEC* v. *Capital Gains Bureau,* 375 U.S. 180 (1963); *United Housing Found.* v. *Forman,* 421 U.S. 837 (1975); *SEC* v. *Natl. Securities, Inc.,* 393 U.S. 453 (1969); and *Radzanower* v. *Touche, Ross & Co.,* —— U.S. —— (6/7/76). It should therefore be summarily affirmed with respect to Santa Fe.*

Counterstatement of the Case

1. Summary Statement.

The complaint in substance alleges the following:

(a) A sham, short form merger without corporate purpose was effected by Santa Fe, the fiduciary of the Kirby Lumber Co. stockholder-beneficiaries, for the purpose of misappropriating their stock, known by the fiduciary to be worth at least $772 per share, for $150 per share, the fiduciary unilaterally fixing that price and pocketing the difference, some $15,000,000. The mechanism was the creation of a paper corporation and "merging" it into Kirby, and cancelling the minority stock at $150 per share. Appraisal Associates on February 19, 1974 had submitted to the defendants a written appraisal of the land (exclusive of minerals), timber, buildings and machinery belonging to Kirby as of December 31, 1973, stating its *market value to be $320,000,000* (39a).** The *book value* of these

* There is now before the Court another certiorari petition arising from the decision below, No. 75-1660, filed by plaintiffs S. William Green, et al. to review the dismissal of the complaint against defendant Morgan Stanley & Co. as an aider and abettor of the principal fraud committed by Santa Fe.

** References to the opinions below are to Appendix C of the Santa Fe Petition for certiorari.

assets was only $9,000,000. The difference of $311,000,000 was $622 per share over and above the book value of those assets of Kirby.

(b) That forced purchase-sale of stock and misappropriation of most of the proceeds by their fiduciary were without the knowledge or consent of the stockholder-beneficiaries and without prior notice of any kind to them.

(c) After said misappropriation the fiduciary, in advising the stockholder-beneficiaries of the consummated freeze-out, attempted to disguise the unconscionableness of the price it had unilaterally fixed by transmitting to them a dishonest appraisal it had obtained for the purpose from Morgan Stanley & Co. that the stock was worth only $125 per share.

(d) The foregoing "device, scheme or artifice" or "act, practice or course of business" (accomplished by the use of means and instrumentalities of interstate commerce and the mails) had the purpose and effect "to defraud", or to "operate as a deceit upon", the stockholder-beneficiaries and their corporation, in connection with the said purchase-sale of stock.

2. More Complete Statement, in No. 75-1660.

For a more complete statement we incorporate the Statement of the Case in our Petition as to Morgan Stanley & Co., No. 75-1660, pp. 2-14.

ARGUMENT

I. Santa Fe's Two Faulty Premises

(1) Santa Fe's petition is based on two premises, neither of which is tenable. *First,* it is not so, that fraud is confined to the verbal—a misstatement or omission to state. *Second,* in fact, Santa Fe is guilty of both misstatement and omission, as well as of non-verbal fraud.

II. The Sham Merger to Mulct the Beneficiary Was a Fraudulent Device or an Act Operating to Deceive

(2) The fiduciary went through the form of a merger without economic substance, creating a paper corporation and merging it into Kirby for the mere purpose of appropriating the minority-beneficiaries' stock at 20% of its true value. That was plainly a sham, a fraudulent device or an act operating as a deceit. *Supt. of Insur.* v. *Bankers Life,* 404 U.S. 6 (1971) applied the first and third clauses of Rule 10b-5 which proscribe non-verbal frauds (at 9), and held that "misappropriation is a 'garden variety' type of fraud" (at 11, n. 7), within the language and contemplation of the Rule and Section 10(b). That case squarely applies to ours. The only difference is that there the fiduciary pocketed all the proceeds and here the fiduciary misappropriated "only" 4/5ths the value of its cestuis' stock, some 15 million dollars. As the Court below held:

> We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. (45a)

(3) *SEC* v. *Capital Gains Bureau,* 375 U.S. 180 (1963) set forth the following as the applicable standard of what constitutes fraud for the purposes of the securities laws:

> [E]quity regarded it [fraud] as a conveniently comprehensive word for the expression of a lapse from the high standard of conscientiousness that it exacted from any party occupying a certain contractual or fiduciary relation toward another party. (193).

It does not take argument to establish that Santa Fe's using a sham merger to misappropriate most of its cestuis' equity constitutes "a lapse from the high standard of conscientiousness . . . exacted fron any . . . fiduciary".* The Court held that scalping** was a species of fraud (at 181); it also noted that "*any practice* which operates 'as a fraud or deceit' " includes non-disclosure "as *one* variety" thereof (198-199).

(4) *United Housing Found.* v. *Forman,* 421 U.S. 837 (1975) held that in applying the securities laws "form should be disregarded for substance and the emphasis should be on economic reality" (848). The Court stated:

> The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Act is on the capital market of the enterprise system: . . . the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying "a transaction, and not on the name appended thereto." (849)

Here there was no economic reality to the merger. A paper corporation was created and immediately "merged" into Kirby Lumber as a mere device whereby Santa Fe,

* In *Supt. of Insurance,* the Court stated, too, that "The Congress made clear that 'disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web' along with manipulation, investor's ignorance, and the like" (404 U.S., at 11-12).

** Scalping is purchasing a security shortly before recommending it and selling immediately after.

the majority holder, could squeeze out the Kirby minority at a small fraction of the true value of the minority's stock. As the Sixth Circuit U.S. Court of Appeals held (*Marsh* v. *Armada Corp.*, 4/5/76, CCH Fed. Sec. L. Repts. ¶ 95,496) in explaining the 2nd Circuit's decision below:

> In *Green* and *Marshel* the merger was a sham transaction designed to expropriate the ownership interests of the minority shareholders (at page 99,525)—

at a small fraction of their value.

The sham merger as a device to misappropriate the beneficiary's property was, plainly, a fraudulent and deceptive act, practice or scheme under this Court's decisions.

(5) *SEC* v. *Natl Securities, Inc.*, 393 U.S. 453 (1969) held that even though a State has approved a merger of two corporations with appraisal rights as the remedy for the minority stock, "The paramount federal interest in protecting shareholders" (463) dictated that the federal court could set aside the merger under Rule 10b-5 (463-4). Delaware didn't sanction fraud and even if it did the paramount federal interest in protecting stockholders from fraud in securities purchase-sales would have to prevail. As the Court stated in *Supt. of Insurance*, 404 U.S. at 12, "practices legitimate for some purposes may be turned to illegitimate and fraudulent means". The Court below didn't rule out all short-form mergers (62a). But sham mergers by a fiduciary to mulct the beneficiary are simply an instance of turning a practice "legitimate for some purposes" into a "fraudulent means."* And in that case, that the State provides an appraisal remedy does not take the case out of the ambit of 10b-5. *Natl Securities, Inc., supra; Supt. of Insurance*, 404 U.S., at 12:

> Since there was a "sale" of a security and since fraud was used "in connection with it", there is redress under Section 10(b), whatever might be available as a remedy under state law.

In *Radzanower* v. *Touche, Ross & Co.*, —— U.S. —— (6/7/76), the Court stated:

> The primary purpose of the Securities Exchange Act was . . . to provide full and honest mechanisms for the pricing of securities and to assure that dealing in securities is fair and without undue preferences or advantages among investors. (CCH Sup. Ct. Bul, at B2986)

and

> The 1934 Act was enacted primarily to halt securities fraud (Id, at 2987).

A sham merger effected to mulct one's cestuis is an "[un]fair and [dis]honest mechanism for the pricing of securities"—a species of "securities fraud" that it was the primary purpose of the 1934 Act to halt.

(6) The sham transaction, whereby the dominant stockholder, a fiduciary, fleeced the minority, its cestuis, in the purchase and sale of securities, implemented by the use of means or instrumentalities of interstate commerce including U.S. mail and telephone, constituted a plain violation of Rule 10b-5 under the settled autorities. It disclosed Santa Fe's flagrant "intent to deceive, manipulate, or defraud" its cestuis in the stock acquisition, striking at the heart of Section 10(b) of the 1934 Act and SEC Rule 10b-5 thereunder, *Ernst & Ernst* v. *Hochfelder*, —— U.S. —— (March 30, 1976), Sl. Op. p. 7. What Santa Fe did is covered by the plain language of section 10(b) and rule 10b-5 and the policy of Congress, as expressed in

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* As long ago as 1201, a writ of deceit could be sued out against a defendant "who had misused legal procedure for the purpose of swindling someone." Prosser on Torts (4th ed. 1971) p. 685.

the legislative history of the section, to prohibit "any other cunning devices" (*Ernst & Ernst, supra,* at p. 16) that operate as a fraud in connection with the purchase and sale of securities. Rule 10b-5 was in fact originally inspired by purchasers' fraudulent and deceitful activities related to an upswing in the economy and to consequent takeovers by insiders of their cestuis' equity (*Ernst & Ernst, supra,* at 26, n. 32; 1 Bromberg, Securities Law—Fraud pp. 22.8-22.9).

(7) Many cases in the lower courts have also found non-verbal, fraudulent or deceptive acts; i.e. other than misstatements or omissions, to be violative of 10b-5 and other fraud provisions of the securties laws. E.g., *Schoenbaum* v. *Firstbrook,* 405 F2d 215 (2nd Cir., en banc), cert. den. 395 U.S. 906, inadequate price paid by controlling stockholder to corporation for stock, with inside knowledge of the true values, violates 10b-5.* We have found no cases to the contrary.

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* Accord: *Drachman* v. *Harvey,* 453 F2d 736 (2nd Cir., en banc), where fiduciary knowingly caused corporation to make improvident redemption of its convertible securities, that was a violation of 10b-5; *Marshel* v. *AFW Fabric Corp.,* —— F2d —— (2d Cir.) (Appendix F to Petition to Sup. Ct. in No. 75-1660), sham merger violates 10b-5; *Mutual Shares Corp.* v. *Genesco, Inc.,* 384 F2d 540 (2nd Cir.), reduction of dividends in order to effect reduction in market price of stock violates 10b-5; *Schlick* v. *Penn-Dixie Cement Corp.,* 507 F2d 374 (2nd Cir.), cert. den. 421 U.S. 976, market manipulation violates 10b-5; *Pappas* v. *Moss,* 393 F2d 865, 869 (3d Cir.), "where, as here, a board of directors is alleged to have caused their corporation to sell its stock to them and others at a fraudulently low price, a violation of Rule 10b-5 is asserted"; *Speed* v. *Transamerica Corp.,* 235 F2d 369 (3d Cir.), inadequate consideration paid by the control group for stock violates 10b-5; *Shell* v. *Hensley,* 430 F2d 819, 827 (5th Cir.), the unfair use of controlling influence in the purchase or sale of securities spells out a fraud under 10b-5; *Rekant* v. *Desser,* 425 F2d 872, 882 (5th Cir.),

> "We conclude, therefore, that when officers and directors have defrauded a corporation by causing it to issue securities for

(*footnote continued on following page*)

Judge Hays had previously dissented in part from the panel's decision in *Schoenbaum,* 405 F2d 200 (C.A.2), then wrote the reversing opinion for the *en banc* Court in *Schoenbaum,* 405 F2d 215, which essentially followed his earlier dissenting panel opinion. In that earlier opinion, Judge Hays stated with respect to the bargain sale of stock to the insider (215):

> What we have here then is a scheme by which the directors of Banff gave to the controlling stockholder (footnote omitted) and an affiliated corporation some millions of dollars worth of this corporation's property. *A plainer case of fraud would be hard to find.*

(*footnote continued from preceding page*)

> grossly inadequate consideration to themselves or others in league with them or the one controlling them, the corporation has a federal cause of action under § 10(b) . . . . The essence of the transaction is not significantly different from fraudulent misrepresentation perpetrated by one individual on another";

Hooper v. *Mountain States Securities Corp.,* 282 F2d 195, 204 (5th Cir.) cert. den. 365 U.S. 814, "the essence of the" 10b-5 "fraud" was "a scheme to get Consolidated to issue . . . stock for worthless property." *Dasho* v. *Susquehanna Corp.,* 380 F2d 262, 270 (7th Cir.), the concurring majority sustained a complaint that a self-deal merger on unfair terms violates 10b-5; *Travis* v. *Anthes Imperal Ltd.,* 473 F2d 515, 527 (8th Cir.), Rule 10-b-5 liability found even though "[t]he essence of the plaintiffs' complaint . . . is that the defendants violated § 10(b) and Rule 10b-5 by engaging in self-dealing. . . . Here, as in *Sup't of Insurance,* the defendants' self-dealing was a violation of a fiduciary obligation to minority shareholders . . ."; *Norris & Hirshberg, Inc.* v. *SEC,* 177 F2d 228 (U.S. Ct. App., D.C.), broker's purchases from, and immediate resales to, trusting customers, at higher prices, violates 10b-5 as fraud on customers; *Associated Securities Corp.* v. *SEC,* 293 F2d 738 (10th Cir.), broker's sale at excessive mark-up over market price violates 10b-5; *Hecht* v. *Harris Upham & Co.,* 283 F.Supp. 417, 432-3 (N.D. Calif.), broker's churning his customer's account, an abuse of confidence, "is a device, scheme or artifice to defraud" in violation of 10b-5; *Cooper* v. *North Jersey* Trust Co., 226 F.Supp. 972, 977-8 (S.D.N.Y.), sale of securities supposedly bought for borrower's account violates 10b-5.

As the U.S. District Court for Delaware held in sustaining a 10b-5 charge (*Voege* v. *Amer. Sumatra Tobacco Corp.*, 241 F.Supp. 369, 375):

> Plaintiff at bar was the subject of deception for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find, according to the complaint, that the terms of the merger were designed to defraud her.

With respect to fraud through self-dealing, Judge Mansfield below stated the following:

> Our conclusion that where there has been self-dealing on the part of corporate insiders, proof of misrepresentation or non-disclosure is not a *sine qua non* to the establishment of 10b-5 liability is shared by other Circuits. (60a-61a).

After citing and quoting from several cases, Judge Mansfield continued as follows:

> Defendants' efforts to reconcile these decisions by searching for some misrepresentation or non-disclosure ignores the court's plain language in each case and exalts form over substance. Such misrepresentations as may be found generally related to technical, trivial matters, having little or no relevance to the manipulative conduct giving rise to 10b-5 liability. Furthermore, in some of the cases the courts, in imposing § 10(b) liability were quite explicit in acknowledging the absence of misrepresentation or openly minimizing its import to the illegal conduct under challenge. (62a)

(8) At common law, too, fraud is not confined to misstatements or omissions to state. E.g. 12 Williston on Contracts (Jaeger ed.), pp. 321-2, 330-1, 332; Bouvier's Law Dict. (Rawle's Third Rev.), entry "Fraud": it in-

cludes "any cunning, deception, or artifice, used to circumvent, cheat, or deceive another." As Prosser stated in discussing fraud by conduct, "actions may speak louder than words." (4th ed., 1971) pp. 694-5.

Thus, the fiduciary's misappropriation* of his cestui's property is, of course, also a fraud at common law, even if there were no misstatements or omissions to state. *Grin* v. *Shine,* 187 U.S. 181, 189, 195 (1902). A sham merger merely to eliminate a minority stockholder has been held to be a fraud against him at common law, *Bryan* v. *Brock & Blevins Co.,* 490 F2d 563, 570-571 (5th Cir.) cert. den., 419 U.S. 844,** and in New York under the Martin Act, *Peop.* v. *Concord Fabrics, Inc.,* 50 AD2d 787 (1st Dept.) aff'g. on op. below, 83 M 2d 120, involving the same merger invalidated under 10b-5 in *Marshel, supra.**** More, generally, "fraud" includes "cases arising from some peculiar confidential or fiduciary relation between the parties, where advantage is taken of that relation by the person in whom the trust or confidence is reposed." Bouvier's Law Dict. (Rawle's Third Rev.), p. 1304 entry "Fraud". The authorities uniformly agree that a fiduciary's taking unfair advantage of his cestui is, without more, a species of fraud at common law. E.g. Amer. Jurisp.2d "Fraud and Deceit": action for fraud and deceit maintainable where fiduciary does not exercise "the utmost good faith in the transaction" or he obtains an unfair advantage "whether the unconscionable advantage was obtained by misrepresentation, concealment or suppression of material facts, artifice, or undue influence" (§ 15,

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* "Misappropriate"—"To appropriate wrongly or misapply in use, especially wrongfully and for oneself". Webster's New International Dictionary, 2nd Ed., Unabridged.

** Accordingly, the Georgia corporate provision making appraisal the exclusive remedy was held inapplicable as a matter of state law.

*** The wording of the Martin Act (N.Y. Gen. Bus. L. § 352(1)) is similar to clauses 1 and 3 of SEC Rule 10b-5.

pp. 38-39). "[I]f in a transaction between parties who stand in a relationship of trust and confidence, the party in whom the confidence is reposed obtains an apparent advantage over the other, he is presumed to have obtained that advantage fraudulently" (§ 441, p. 602).*

Indeed, at common law, even in the absence of a fiduciary relationship, the "inadequacy of consideration may be so flagrant as of itself to afford a presumption of fraud." Am. Jurisp. 2d, *supra,* at § 440, p. 601. Accord: 3 Pomeroy, *supra,* § 927, p. 634. If the disproportion is great enough it may furnish "decisive evidence of fraud." *id.* Here Santa Fe appropriated ⅘ths of the minority's stock value. The disproportion becomes even more significant as to "the fact of fraud" because there was no "deliberation by the parties [seller and purchaser]", Pomeroy, *supra,* § 928, p. 637—Santa Fe having fixed the price unilaterally and effected the transaction without the knowledge or consent of the stockholder sellers.

III. Moreover, There Was Both Non-Disclosure and Misstatement

A. The Non-Disclosure

(9) The merger was consummated without any notice or disclosure whatsoever to the minority stockholders of Kirby or consent by them. The first they heard of it was

* Accord: 3 Pomeroy's Equity Jurisp. (5th ed. Symons) p. 421: "Every fraud, in the most general and fundamental conception, consists in obtaining an undue advantage by means of some act or omission which is unconscientious or a violation of good faith in the broad meaning given to the term by equity,—the *bona fides* of the Roman law."; Prosser on Torts (4th ed. 1971) p. 697.

At common law, a strict Trustee may in no event buy his cestui's property from himself because of the temptation to defraud. Bogert, Trusts and Trustees (2d ed.) § 543, n.2.10.

when Santa Fe informed them that their stock had already been taken by Santa Fe at $150 per share and if they didn't like it their only remedy was an appraisal proceeding. As Judge Mansfield held below (58a-59a):

> Defendants place heavy reliance upon *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972), as representing a departure from our steady trend toward an expansive view of the reach of the federal security laws. However, to the extent that *Popkin* is at all relevant to the short-form merger context, it impliedly supports the application of the *Schoenbaum-Drachman* rule to this case. In *Popkin,* unlike the present case, *prior* stockholder approval of the proposed merger was required. Full *advance* disclosure of the relevant facts regarding the merger exchange ratios to the minority stockholders was effective protection because it gave them the opportunity, as Judge Feinberg noted, to seek state court injunctive relief which was purportedly available under Delaware law. *Id.* at 720. Here, in contrast, disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out. Indeed, it is well recognized that the state post-merger appraisal procedure does not provide an alternative remedy comparable to federal relief. (footnotes omitted)

(10) The authorities are in accord with the decision below that only disclosure before the fact could in any event give the kind of investor protection contemplated by the anti-fraud provisions of the securities laws.* Thus, Harlan, J., explaining why purchase, cheap, by the control, on inside information, violated 10b-5 (*Speed* v. *Trans-*

* Though a non-verbal fraud may not be neutralized even by advance disclosure, *Marshel, supra.*

ameria Corp., 235 F2d 369) stated:

> Had shareholders been aware of the concealment, they would undoubtedly have refused to sell. *Capital Gains Bureau, supra,* 375 U.S. 180, at 205 (dissg. op.).

The disclosure must be in advance so that the investor can protect himself by preventing the sale. Telling him after the sale is shutting the barn door after stealing the horse. So in *Bailey* v. *Meister Brau, Inc.,* —— F2d —— (7th Cir.), 5/6/76, CCH Fed. Sec. L.Rep. ¶ 95,543, the Court held that it was a violation of 10b-5 for "the controlling stockholder [to cause] the corporation to engage in a securities transaction in which the stockholder has a conflict of interest [and which] was unfair to the corporation," because he had not disclosed information "which reflects on the fairness of the transaction" to "the only stockholder whose interests lay with the corporate entity":

> He was thus deprived of any opportunity to protect the interests of the corporation and of himself as minority shareholder (p. 99,735).*

B. The Misstatement

(11) A material part of Santa Fe's scheme consisted in obtaining a fraudulent appraisal from Morgan and in persuading the minority stockholders that the $150 it had unilaterally fixed for each share was fair; that would deter challenges in the courts. To that end it paid Morgan $125,000 for Morgan's undervaluation of Kirby stock at $125, worth at least $772 per share.

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* Cf. *Nader* v. *Allegheny Airlines,* —— U.S. —— (6/7/76), a common law action of fraud and deceit was maintainable by a passenger for nondisclosure by an airline of its overbooking practice which resulted in his being bumped, even though he was subsequently informed that by reason of the overbooking he could obtain compensation for the bumping.

By transmitting the dishonest appraisal to the stockholders, Santa Fe adopted, and made its own, a misstatement, as part of its fraudulent scheme.

IV. Santa Fe's Petition Misrepresents the Plaintiffs' Position in the Lawsuit

(12) Contrary to the Petition, plaintiffs have never conceded at any time "the absence of any deceit" (Pet. p. 7), or that the gravamen of the complaint was "merely" undervaluation (Pet. p. 7), or that there was full disclosure (Pet. p. 3), or no misrepresentation (Pet. p. 3).

V. "Volume of Litigation"

(13) The decision below proscribes under 10b-5 sham mergers by which fiduciaries cheat their cestuis. This decision is compelled by the language and purpose of the rule and by the decisions of this Court; in addition, it will deter such sham mergers and so (contra Pet. p. 6) hardly, if at all, increase the number of cases.

VI. "A Federal Common Law of Corporations"

(14) This contention (Pet. p. 6) is meaningless hyperbole. The securities laws, designed to prohibit securities purchase-sale frauds effected via the U.S. mail or interstate commerce, are a constitutional exercise of federal supremacy. Section 10-b is a mandate of Congress and rule 10b-5 was validly promulgated thereunder. The federal courts will therefore enforce it "flexibly, not technically and restrictively." *Supt. of Insur., supra,* 404 U.S., at 12. See further paragraph (5) above, at 6-7.

Conclusion

That a sham merger, devised by a fiduciary simply to mulct its beneficiaries of $\frac{4}{5}$ths of the value of their stock, consummated without any notice whatever to them and involving a dishonest appraisal transmitted with the post-merger notice to them, is fraud, needs no further briefing or oral argument.

The judgment reinstating the complaint against Santa Fe should be summarily affirmed.

Respectfully submitted,

Sidney Bender
Attorney for Respondents

Of Counsel:

Aaron Lewittes

IN THE

Supreme Court of the United States

OCTOBER TERM 1976

No. 75-1753

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC. and KIRBY LUMBER CORPORATION,

Petitioners,

against

S. WILLIAM GREEN, ET AL.,

Respondents.

BRIEF ON BEHALF OF PETITIONERS

WILLIAM R. GLENDON
Attorney for Petitioners
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

Of Counsel

ROGERS & WELLS
ROBERT D. LARSEN
GUY C. QUINLAN
GENE M. BAUER
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

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Opinions Below

The opinion of the United States District Court for the Southern District of New York, reported at 391 F.Supp. 849, is printed at pages 105a-116a of the Appendix hereto. The opinions in the United States Court of Appeals for the Second Circuit, reported at 533 F.2d 1283, are printed at pages 119a-175a in the Appendix. The memorandum of the Court of Appeals denying rehearing *en banc*, reported at 533 F.2d 1309, is printed at pages 176a-178a in the Appendix.

Jurisdiction

The jurisdiction of this Court is invoked pursuant to 28 USC § 1254(1). The judgment of the Court of Appeals for the Second Circuit was entered on February 18, 1976. Petitioners' timely petition for rehearing was denied on March 10, 1976. The petition for certiorari was filed on June 2, 1976. This Court granted certiorari on October 4, 1976.

Constitutional Provisions, Statutes and Regulations

Involved herein are the Tenth Amendment to the Constitution of the United States, Section 10(b) of the Securities Exchange Act of 1934, 15 USC § 78j(b), Securities and Exchange Commission Rule 10b-5, 17 CFR 240.10b-5 and Sections 253 and 262 of the Delaware Corporation Law, the texts of which are printed in the Appendix hereto.

Questions Presented for Review

1. May an action be maintained under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder, where there is no allegation of any misrepresentation or nondisclosure, and solely on the basis of allegations that the stock of minority stockholders of a company involved in a short form merger was undervalued, and that there was no "corporate purpose" for the merger?

2. Do Section 10(b) and Rule 10b-5 authorize a federal court, in the absence of any allegation of misrepresentation or nondisclosure, to condemn, as a breach of corporate "fiduciary duty," conduct which is expressly sanctioned by the state which created the corporation, and to impose requirements of "corporate purpose" and advance notice on the use of a state short form merger statute, when it is conceded that the law of the state imposes no such requirements?

Statement of the Case

This is an action in which plaintiffs, who were minority stockholders of the Kirby Lumber Corporation ("Kirby"), originally complained of the alleged undervaluation of their stock, at $150 per share, in connection with a corporate merger. The controlling interest in Kirby, a Delaware corporation, was owned by petitioner Santa Fe Natural Resources, Inc. ("Resources"), which in turn is wholly owned by petitioner Santa Fe Industries, Inc. ("Santa Fe"), the parent company of The Atchison Topeka and Santa Fe Railway Company. A subsidiary of Santa Fe acquired approximately 60 percent of the stock of Kirby in 1936, as a result of the reorganization of Kirby's predecessor. Over the succeeding years, Santa Fe and its subsidiaries, including Resources, made additional purchases of Kirby stock. In 1967, pursuant to a tender offer at $65 per share, a predecessor of Resources increased its ownership to approximately 95 percent of the stock of Kirby. Between 1968 and 1973, Resources and its predecessor purchased small additional amounts of Kirby stock, at prices ranging from $65 to $92.50 per share (A 33a).*

Section 253 of the Delaware Corporation Law ("DCL") permits a parent corporation, which owns at least 90 percent of the stock of a subsidiary, to merge with that subsidiary, upon approval by the parent's board of directors, and to make payment in cash for the shares of the minority stockholders. Section 253, known as the "short form merger" statute, does not require consent of, or advance notice to the minority stockholders. However, notice of the merger must be given within 10 days after its effective

* Citations to "(A)" are to the Appendix herein.

date, and any stockholder who is dissatisfied with the amount offered for his shares is entitled to obtain an appraisal in the Delaware Court of Chancery. DCL §§ 253(d), 262.

Resources decided to invoke Section 253, and complied fully with the provisions of the statute. Resources obtained, from independent appraisers, written appraisals of the physical assets of Kirby (A 82a-84a). These appraisals, in turn, were submitted to the investment banking firm of Morgan Stanley & Co. ("Morgan Stanley"), which had been retained to make an independent valuation of the stock. Morgan Stanley submitted a report valuing the stock at $125 per share (A 80a-81a). Resources thereafter decided to pay the minority stockholders $150 per share (A 12a) —a figure more than 50 percent above the highest price at which Kirby had traded for many years (A 33a).

To implement the short form merger, Resources caused to be organized another Delaware corporation, Forest Products, Inc. ("FPI"). Resources transferred to FPI its approximately 95 percent holding of Kirby stock, and gave to FPI the sum of $3,798,675, which was the amount necessary to pay $150 per share to the holders of the 25,324½ minority shares.* Resources also assumed certain liabilities, and assumed all costs and expenses of FPI and Kirby in connection with the merger (A 20a).

On July 31, 1974, FPI was merged with Kirby, with Kirby as the surviving corporation. In compliance with the Delaware statute (DCL § 253 (b)), the minority stockholders of Kirby were notified of the merger on August 1, 1974, and were advised of their right to receive $150 per

* The court below erroneously assumed (see 533 F.2d at pages 1285, 1289, 1290) that corporate funds of Kirby were used to make the cash payments to minority stockholders. In fact, the record is clear that the funds of Kirby were not used for this purpose (A 19a-20a).

share, or to obtain appraisal if they were dissatisfied with that amount (A 12a-14a).

With the notice, the minority stockholders received an extensive and detailed information statement (A 15a-98a). Plaintiffs herein do not challenge the accuracy or completeness of the information statement; on the contrary, all of plaintiffs' assertions of undervaluation were derived from the information furnished by the defendants to the minority stockholders (see 533 F.2d at pages 1288-9). Plaintiffs thus do not dispute that all of the material facts were made available to the minority stockholders, prior to the time when stockholders had to decide whether to accept the $150 per share, or press their claim for an appraisal pursuant to Delaware law. The statement sent to minority stockholders contained, in addition to substantial financial data about Kirby:

1. an opinion by Morgan Stanley that the fair market value of the Kirby stock was $125 per share (A 80a-81a) (although the highest actual sale price had been $92.50 (A 33a));

2. an appraisal of Kirby's land, timber, buildings and machinery conducted by Appraisal Associates (A 82a-84a); and

3. an appraisal of Kirby's oil and gas royalty interests and Kirby's ownership in mineral properties by Riggs and Associates, a firm of petroleum reservoir consultants (A 85a-97a).

On August 21, 1974, plaintiffs invoked their right of appraisal under Delaware law. On September 9, 1974, however, plaintiffs purported to withdraw their demand for appraisal,* and filed the present action on the following day.

* However, a number of other stockholders pressed their requests for appraisal, and discovery proceedings are now in progress in the Delaware Court of Chancery. *Bell, et al.* v. *Kirby Lumber Corporation,* C.A. No. 4076.

Plaintiffs' original complaint against Santa Fe and Morgan Stanley alleged that the fair market value of Kirby's land and timber exceeded its book value by an amount equivalent to $622 per share, and that this amount "added to the $150 per share, yields a value of at least $772 per share." It was alleged that "freezing out the minority stockholders of Kirby at the grossly undervalued price of $150 per share" constituted "a manipulative and deceptive device in breach of SEC Rule 10b-5 and a breach of fiduciary obligation owed to Kirby and its minority stockholders" (A 6a).

Defendants moved to dismiss the complaint for failure to state a claim, on the ground that, assuming *arguendo* that the stock was undervalued as alleged,* no claim of deception or nondisclosure was made, and the complaint merely asserted an appraisal claim, which should properly be brought in the Delaware state courts.

Thereafter, plaintiffs amended their complaint (A 99a-104a) to add the allegation that the merger had been conducted "without prior notice" to the minority stockholders. It is undisputed that the Delaware statute does not require notice prior to the merger, and that the minority stockholders received the information statement in ample time to make a demand for appraisal. By stipulation, the motion to dismiss was deemed addressed to the amended complaint.

* In fact, in the Delaware appraisal action, these figures are sharply disputed. As noted, the price paid to minority stockholders was far above any price at which the shares had traded for many years. Also, the law of Delaware is clear that the value of the stock is not determined solely by liquidation or asset value, but includes all other relevant factors, such as market value, dividend value, and earnings value. *See, e.g., Application of Delaware Racing Ass'n*, 213 A.2d 203 (Del. Sup.Ct. 1965). Further, there is no valid basis even on plaintiffs' theory for *adding* the $150 per share tendered by defendants to the asset value figure computed by plaintiffs. None of these issues, however, were presented by the motion addressed to plaintiffs' purported claim under the federal securities laws.

The District Court granted defendants' motion to dismiss for failure to state a claim, noting the complete absence of any allegation of misrepresentation or nondisclosure, and holding (391 F.Supp. at page 853):

> "The primary objective of Rule 10b-5 is to impose a duty of disclosure upon a corporation and its controlling persons. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). That objective is to be achieved in conjunction with the state corporate law. This Court does not regard Rule 10b-5 as an omnibus federal corporation law having such broad reach as to modify the notice requirements of the Delaware merger statute, or prevent Delaware, in its legislative wisdom, from providing a means by which a majority can exclude a minority from the corporation's future affairs, so long as due process is satisfied, as it is here, by the appraisal procedures."

A divided panel of the Court of Appeals reversed the dismissal of the complaint. The majority held that the requirements of Rule 10b-5 were satisfied by the allegation of "a breach of fiduciary duty," even in the absence of misrepresentation or nondisclosure (533 F.2d at page 1287), and stated (*ibid.*):

> "Our later review of the decisions of this Court on the subject of allegations under Rule 10b-5 of breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure will, we think, demonstrate that in such cases misrepresentation or lack of disclosure are not essential ingredients of the claim for relief by the minority. But, lest there be any lingering doubt on

> this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary."

Thereafter the full bench of the Court of Appeals, noting that review by this Court was anticipated because of the "extraordinary importance" of the issues presented (533 F.2d at page 1310), denied rehearing *en banc*.

Summary of Argument

The court below erred in eliminating misrepresentation and nondisclosure as necessary elements of a claim under Section 10(b) and Rule 10b-5. The purpose of these provisions is to substitute full disclosure for the philosophy of *caveat emptor*. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 151; *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 744. Where all the material facts have been fully and accurately disclosed, as in the present action, Rule 10b-5 cannot validly be invoked in order to pass judgment on the merits of the underlying transaction.

Any construction of Rule 10b-5 must turn first to the language of the statute itself, since the scope of the rule promulgated by the Securities and Exchange Commission cannot exceed the power granted to the Commission by Congress. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 213-4. Section 10(b), by its terms, is expressly concerned with deception. The numerous decisions prior to the present action, holding that deception is an essential element of a Rule 10b-5 claim, are clearly mandated by the language and purpose of the statute.

Contrary to the statute, the decision below would extend Rule 10b-5 to cover virtually all appraisal and valuation cases which have previously been heard in the state courts. Although plaintiffs have sought other labels for their claim in an effort to maintain it in the federal courts, the gravamen of their complaint is still the alleged undervaluation of their stock. Further, the opinion of the majority would extend Rule 10b-5 beyond short form mergers, to cover any alleged "breach of fiduciary duty" by a majority shareholder. Under this standard, virtually all corporate and shareholder litigation would henceforth fall within the scope of the federal securities laws, by the mere addition of a claim of fiduciary misconduct.

In reaching this result, the court below condemned, as "a breach of fiduciary duty," a transaction expressly authorized by the legislature and sanctioned by the courts of Delaware, and has treated as a "fraudulent device" the statute of a sovereign state. The establishment of a new rule of federal common law, nullifying the state short form merger statute, disregards principles established by applicable decisions of this Court, from *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 to *Cort* v. *Ash,* 422 U.S. 66.

Such drastic federal preemption, in an area traditionally committed to state regulation, would raise serious constitutional questions under the Tenth Amendment, even if it were supported by the statute. Certainly, such a preemption should not be permitted in the absence of a clear Congressional intent. *See, e.g., United States* v. *Bass,* 404 U.S. 336, 349; *Apex Hosiery* v. *Leader,* 310 U.S. 469, 513. No such intent can properly be inferred from the language of Section 10(b). Further, the decision below does not even substitute any clear or coherent standard for the state law which it has overriden. If state corporate law is indeed to be preempted in this area, it should be done by Congressional action, and not by judicial legislation.

ARGUMENT

The Court of Appeals Erred in Eliminating Misrepresenation and Nondisclosure as Necessary Elements of a Claim Under Section 10(b) and Rule 10b-5

Less than a year after this Court reaffirmed the historic relationship of Rule 10b-5 to the "tort of misrepresentation and deceit," *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 744, the decision below has excised misrepresentation and nondisclosure as elements of Section 10(b) and Rule 10b-5. In effect, the Court of Appeals has transformed Section 10(b) from a disclosure provision into a mandate for the substantive regulation of corporate affairs, thereby supplanting state corporation law. In so doing, the Second Circuit disregarded the prior holdings of this Court that the fundamental purpose of the 1934 Act is "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor. . . .*" *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 151; *S.E.C.* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186. In order to reach its result, the lower court was also obliged to disregard the language of the statute itself, which makes deception or nondisclosure an indispensable part of any claim under Section 10(b).

The majority of the panel below sought to minimize the extent of its abrupt departure from existing law by citing (533 F.2d at page 1290) this Court's often quoted statement that "Section 10(b) must be read flexibly, not technically and restrictively." *Superintendent of Ins.* v. *Bankers Life and Cas. Co.,* 404 U.S. 6, 12. That principle, however, does not support the result reached by the lower court. Section 10(b) has indeed been read "flexibly" to reach many ingenious forms of deceit in many different forms of transaction. However, to eliminate deceit from the statute entirely, as the Court of Appeals has done here, is not

flexible interpretation, but judicial amendment. The process of interpretation cannot validly be stretched to "add a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 199.

As this Court noted in *Hochfelder,* any construction of Rule 10b-5 must "turn first to the language of § 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself.'" 425 U.S. at page 197, quoting *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756. The terms of the statute, as the Court further noted in *Hochfelder,* make unlawful the use of "any *manipulative or deceptive* device or contrivance" [emphasis added] in contravention of rules established by the Commission. No allegation of manipulation, as the term is used in the statute, is here involved.* The issue, therefore, is whether the court below erred in extending the statute, which prohibits "deceptive" devices, to cover cases where there is a complete absence of any deception whatsoever.

A large body of authority over the years, including several decisions in the Second Circuit itself, has squarely held that Section 10(b) is inapplicable to situations where deception and nondisclosure are absent. Thus, in *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972), the court noted, after reviewing a number of Rule 10b-5 decisions (464 F.2d at pages 719-20):

> "Thus, it seems clear that our emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases. Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to

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* As this Court noted in the *Hochfelder* case, 425 U.S. at page 199, the term "manipulative" was "virtually a term of art," relating to "conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."

become enmeshed in passing judgments on information elicited."

The decision in *Popkin,* a long form merger case, which the Second Circuit has now impliedly overruled, was in accord with holdings in the Fifth and Seventh Circuits that "the gravamen of a 10b-5 cause of action is deception," and that no action under the Rule may be maintained in the absence thereof. *Bailes* v. *Colonial Press, Inc.,* 444 F.2d 1241, 1246 (5th Cir. 1971). *Accord, Rosin* v. *New York Stock Exchange, Inc.,* 484 F.2d 179, 183 (7th Cir. 1973), *cert. denied,* 415 U.S. 977. *See, also, Aboussie* v. *Aboussie,* 441 F.2d 150 (5th Cir. 1971); *Azalea Meats, Inc.* v. *Muscat,* 386 F.2d 5, 8 (5th Cir. 1967).

The majority of the court below sought to distinguish *Popkin* by asserting that, since a short form merger transaction does not require the approval of minority stockholders, disclosure to the stockholders is therefore irrelevant (533 F.2d at page 1291). Any such argument, however, was succinctly refuted by the court in *Popkin* (464 F.2d at page 720, note 16):

> "Where the right to appraisal and payment for shares is the exclusive shareholder remedy under state law, the federal disclosure provisions are still not 'nugatory.' They will help ensure that shareholders have the information necessary for an intelligent exercise of their appraisal rights."

The majority opinion below also sought to support its expansion of Rule 10b-5 by the argument (533 F.2d at pages 1286-7) that only subdivision (b) of the Rule specifically mentions misrepresentation and nondisclosure, while subdivisions (a) and (c) speak simply of "any device, scheme, or artifice to defraud," and "any act, practice, or course of business which operates or would operate as a fraud or deceit. . . ." From this, the majority of the panel proceeded to argue that "fraud" should be defined broadly enough to include conduct where no element of deceit was

present, such as plaintiffs' allegation "that the stock was grossly undervalued and that there was no justifiable corporate reason for the merger" (533 F.2d at page 1287). As noted above, however, the statute which furnishes the authority for Rule 10b-5 speaks specifically in terms of deception. If subdivisions (a) and (c) had indeed been intended to dispense with any element of deceit or nondisclosure, they would have exceeded the Commission's rule making authority under the statute. As this Court held in *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at pages 212-14:

> "More importantly, Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is ' "the power to adopt regulations to carry into effect the will of Congress as expressed by the statute," ' *Dixon* v. *United States,* 381 U.S. 68, 74 (1965), quoting *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134 (1936). Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)."

So here, petitioners submit that the Commission could not have eliminated deception from the statute by issuing a rule, and that the court below erred in doing so under the guise of interpretation.

In support of its expanded reading of subdivisions (a) and (c), the Court of Appeals also cited (533 F.2d at page 1290) language from a decision under the Investment Advisers Act of 1940, stating that " 'fraud' " as defined by " 'a court of equity' " covers numerous types of " 'breach of legal or equitable duty, trust and confidence.' " *S.E.C.* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 194, quoting from *Moore* v. *Crawford,* 130 U.S. 122, 128. Unlike

Section 10(b), however, the Investment Advisers Act is a comprehensive regulatory statute, laying down substantive federal standards of fiduciary responsibility for investment advisers. As the Court noted in the *Capital Gains* case (375 U.S. at pages 191-2):

> "The Investment Advisers Act of 1940 thus reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."

Moreover, the "fraud" involved in *Capital Gains* was, in fact, a nondisclosure. The issue therein, as stated by the Court (375 U.S. at page 181), was "whether under the Investment Advisers Act of 1940 the Securities and Exchange Commission may obtain an injunction compelling a registered investment adviser to disclose to his clients a practice of purchasing shares of a security for his own account shortly before recommending that security for long-term investment and then immediately selling the shares at a profit upon the rise in the market price following the recommendation." The Court in *Capital Gains* emphasized that the only relief sought was the " 'mild prophylatic' " of full disclosure (375 U.S. at page 193), and held (375 U.S. at page 201):

> "The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statute to confine its application to 'dishonest' as opposed to 'honest' motives. . . . The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients."

Thus, the decision in *Capital Gains* furnished no basis for eliminating nondisclosure from Rule 10b-5.*

In initiating this radical transformation of Section 10(b) and Rule 10b-5, the court below has also disregarded "the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5" (see *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. at page 740). At a minimum, the decision by the Court of Appeals would extend federal jurisdiction to appraisal and valuation cases which heretofore have normally been litigated in the state courts. See Note, 89 Harv. L. Rev. 1917, 1928-9 (1976). To be sure, the majority opinion indicated that Rule 10b-5 would be extended to cover claims of undervaluation only in the absence of a "valid corporate purpose" (533 F.2d at page 1292). However, as discussed below, short form mergers serve a variety of corporate purposes by their very nature;** the majority opinion does not indicate what additional "corporate purpose," if any, could suffice to prevent a shareholder from transforming his state appraisal claim into a federal securities

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* The Rule 10b-5 cases cited in the majority opinion also involved nondisclosure. Thus, *e.g.*, in *Schoenbaum* v. *Firstbrook,* 405 F.2d 215 (2d Cir. *en banc* 1968), *cert. denied sub nom., Manley* v. *Schoenbaum,* 395 U.S. 906, cited by the majority at 533 F.2d at page 1290, the defendants had caused the corporation to sell stock at an unreasonably low price, without disclosing that they had inside information of a major oil discovery which would greatly increase the value of the shares. In *Voege* v. *American Sumatra Tobacco Corp.,* 241 F.Supp. 369 (D. Del. 1965), cited at 533 F.2d at page 1290, the defendants had acquired their 90% position through a tender offer, in connection with which they concealed the fact that they planned a partial liquidation of assets which would result in a higher yield per share than the total price being offered (241 F.Supp. at page 373).

** See pages 21-3, *infra*.

action. In fact, plaintiffs have no real interest in the presence or absence of a "corporate purpose"; their sole objective is to obtain as much money as possible for their stock.* Conversely, no corporate purpose, however compelling, would eliminate plaintiffs' dissatisfaction with the alleged undervaluation. The decision below would, in fact, merely make the federal courts a duplicate forum for the appraisal procedure already available in the state courts of Delaware, merely by the addition of an amorphous charge of "no corporate purpose."

The reach of the decision below, moreover, extends far beyond merger and appraisal situations. Elsewhere in its opinion (533 F.2d at page 1289), the panel stated that its decision applies to any *"Breach of Fiduciary Duty by Majority Shareholders with Resulting Detriment to the Minority. . . ."* [emphasis in original] Indeed, under the lower court's new proposed reading of Section 10(b), it is difficult to see how any stockholder or derivative litigation, previously cognizable only in the state courts, could fail to state a claim under the federal securities laws.

The Second Circuit's proposed expansion of Rule 10b-5 is, moreover, both vague and apparently unlimited. The "fiduciary duty" said to have been violated was clearly not established by Delaware law, since the legislature and courts of Delaware have made it very clear that no such duty was violated by the action of defendants herein (see pages 19-21, *infra*). It is entirely unclear, however, what the source or extent of this "fiduciary duty" actually is, or what the "breach" consists of. Thus, both the majority and concurring opinions below stated that "fiduciary duty" is breached if "corporate funds" are used to purchase the minority stock interest (533 F.2d at pages 1285, 1289,

* "We need not argue that every short form merger without business purpose is in violation of Rule 10b-5; the gravamen of our complaint is that the price is unconscionable—a violation whether or not it has a business purpose." Plaintiffs' Brief in the Court of Appeals, page 33.

1290); in this case, however, the record is undisputed that Resources supplied the funds for the payments made to minority stockholders, and that no corporate funds of Kirby were used for this purpose (A 20a). Again, the concurring opinion dwells at length on the unfairness of cases where companies "go public" at inflated prices and then repurchase stock from the public at a fraction of the original price (533 F.2d at page 1295). Yet, the record was undisputed that Kirby was publicly held before Resources acquired its interest, and that the price paid by Resources was the highest price paid for Kirby stock in many years (A 33a).

In radically expanding Rule 10b-5, beyond the scope of the statutory language, the court below has created a virtually unlimited potential for confusion and uncertainty. The adverse effects of such uncertainty, and of the vast increase in litigation which would inevitably result, were forcefully stated in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 747-8:

> "While much of the development of the law of deceit has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good. In *Ultramares Corp.* v. *Touche*, 255 N.Y. 170, 174 N.E. 441 (1931), Chief Judge Cardozo observed with respect to 'a liability in an indeterminate amount for an indeterminate time to an indeterminate class':
>
> > " ' "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences." ' *Id.*, at 179-180, 174 N.E., at 444."

See, also, Ernst & Ernst v. *Hochfelder*, 425 U.S. 185, 214-5, n. 33.

Plaintiffs have argued in the alternative (Brief in Opposition to Petition, pages 12-4) that there was "non-disclosure" on the facts here, because there was no premerger notice. Such notice is irrelevant since under Delaware law there is no right to enjoin a short form merger, *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78 (Del. Sup. Ct. 1962).* The information statement was distributed well before minority stockholders were required to decide between tendering their shares and demanding appraisal, which is the relevant notice for a short form merger. *Popkin* v. *Bishop, supra,* 464 F.2d at page 720, note 16. *See, also, Ryan* v. *J. Walter Thompson Co.,* 453 F.2d 444 (2d Cir. 1971), *cert. denied,* 406 U.S. 907.

It is clear that the decision below must rest, as the majority of the panel frankly recognized, on a holding that "no allegation or proof of misrepresentation or nondisclosure is necessary" to support a claim under Rule 10b-5 (533 F.2d at page 1287). We submit that such a result is contrary to the language of the statute, to previously existing authority, and to sound considerations of policy, and that accordingly this decision should be reversed.

* As there stated:

"Indeed it is difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle a minority to set aside the merger. This is so because the very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise. Thereafter the former stockholder has only a monetary claim." 187 A.2d at 80.

The Decision of the Court Below Would Create a Federal Common Law of Corporations Contrary to Valid State Statutes

The majority of the court below held that the complaint sufficiently pleaded a breach of corporate "fiduciary duty," in alleging that the short form merger was implemented without a valid corporate purpose (533 F.2d at page 1291). The court below specifically recognized that the applicable Delaware statute provides for elimination of minority interests under ten percent "without prior notice to the minority shareholders, [and] without any statement of corporate purpose" (533 F.2d at page 1289), and it is not disputed that Resources and Kirby complied meticulously with the requirements of the statute.

The majority nevertheless proceeded to hold that the implementation of the short form merger procedure, expressly sanctioned by the legislature and courts of Delaware,* constituted in itself a "fraud" and breach of "fiduciary duty" as a matter of federal law. It did so in a situation where the Supreme Court of Delaware has clearly held that no such fiduciary duty exists, and that the holders of a less than ten percent minority interest have no vested right to remain stockholders. *See, e.g., Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78, 80 (Del. Sup. Ct. 1962). ("This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of breach of trust. . . .")

In brushing aside the Delaware statute with the comment that state remedies are "not preemptive or exclusive," and that remedies under the Exchange Act "are

* *See, e.g., Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78 (Del. Sup.Ct. 1962); *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. Sup.Ct. 1959); *Braasch* v. *Goldschmidt*, 199 A.2d 760 (Del. Ch. 1964). *See, also, Carl Marks & Co.* v. *Universal City Studios, Inc.*, 233 A.2d 63 (Del. Sup.Ct. 1967).

supplementary to those provided by the states" (533 F.2d at page 1286), the majority of the court below simply begs the question. The Supreme Court of Delaware has squarely held that "the very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise." *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78, 80 (1962). In holding that the invocation of the Delaware statute can constitute a "fraud" under Rule 10b-5, the court below has not "supplemented" state law, but rather has flatly contradicted it, and has deliberately overruled policy judgments made by the legislature and courts of the state.

The result reached by the Court of Appeals is in conflict with the spirit of applicable decisions of this Court, from *Erie R. Co.* v. *Tompkins*, 304 U.S. 64, to *Cort* v. *Ash*, 422 U.S. 66. Indeed, even if this drastic preemption of state corporate law were mandated by the statute, it would raise serious questions under the Tenth Amendment. *Cf. National League of Cities* v. *Usery*, —— U.S. ——, 96 S. Ct. 2465. However, such far reaching preemption of state law finds no support in the statutory language.

This Court has repeatedly held that an intent to preempt areas of traditional state regulation, or to make extensive changes in the balance of federal and state jurisdiction, "is not lightly to be imputed to Congress." *Apex Hosiery* v. *Leader*, 310 U.S. 469, 513. As this Court held in *United States* v. *Bass*, 404 U.S. 336, 349:

> "In traditionally sensitive areas, such as legislation affecting the federal balance, the requirement of clear statement assures that the legislature has in fact faced, and intended to bring into issue, the critical matters involved in the judicial decision."

Accord, United States v. *Gambling Devices*, 346 U.S. 441, 450.

Further, this Court has made it clear that this essential principle of federalism applies specifically to the regula-

tion of corporate affairs. As was held in *Cort* v. *Ash*, *supra*, in disallowing a federal civil damage remedy for illegal corporate political contributions (422 U.S. at pages 84-5):

> "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation. . . . We are necessarily reluctant to imply a federal right to recover funds used in violation of a federal statute where the laws governing the corporation may put a shareholder on notice that there may be no such recovery."

So here, stockholders of Kirby, like stockholders of every other Delaware corporation, were on notice that the short form merger procedure was a part of the state's corporation law, and a part of the contractual relations between majority and minority stockholders. *See, also, Cohen* v. *Beneficial Loan Corp.*, 337 U.S. 541, 550-1.

The broad sweep of the decision below does violence to principles of federalism and of sound statutory construction. In the absence of a clear intent to the contrary, federal legislation, which is normally of limited scope and purpose, should be construed to supplement state law and not to supplant it. As was stated in *Hart and Wechsler's The Federal Courts and the Federal System* (2d Ed., Bator *et al.*, 1973) at pages 470-1:

> "Federal legislation, on the whole, has been conceived and drafted on an *ad hoc* basis to accomplish limited objectives. It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose. Congress acts, in short, against the background of the total *corpus juris* of the states in much the way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation."

In overriding the Delaware law, the majority of the court below clearly indicated its disapproval of Delaware statutes which it believed to be "favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the members of the legal profession located in Delaware" (533 F.2d at page 1289).* In fact, however, short form merger statutes like that enacted in Delaware do serve a variety of corporate purposes. As Judge Moore noted in his dissenting opinion (533 F.2d at page 1308):

> "The benefits to a corporation are varied. Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment—these are some of the advantages which may enure to a corporation 'going private'. It is essential to underscore that *all* of the above-stated advantages accrue from the *very act of eliminating the 10% shareholders who confer public status on the corporation.*" [emphasis in original] [footnotes omitted]

As one law review commentator has noted, the short form merger statutes which a majority of the states have enacted

* In fact, as noted in Judge Moore's dissent (533 F.2d at page 1299), at least 38 of the 50 states have similar merger statutes. Moreover, this type of short form merger statute did not originate in Delaware, as the majority suggests (533 F.2d at page 1289); rather Section 253 is modeled upon an earlier statute in New York, *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78, 80 (Del. Sup.Ct. 1962); *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 892, 898 (Del. Sup.Ct. 1959).

may be taken to represent "a substantive determination that take-outs are socially desirable transactions when within the percentage limitations of such statutes." Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U.L. Rev. 987, 1025 (1975). In a federal system, state law on such points should not be lightly disregarded or overruled.

One may take issue—as the majority of the court below obviously did—with the policy judgment of the Delaware legislature that such corporate objectives are a sufficient basis for the enactment of a short form merger statute. Conversely, one might conclude, with the dissent below, that the majority's view of a "justifiable corporate purpose" is "a completely irrational concept that bears no reasonable relationship to the realities of short-form mergers in the actual business world" (533 F.2d at pages 1308-9). However, the issue here presented is whether a federal court should substitute its conclusion on the issue for that of the state legislature. In choosing to do so, the majority below disregarded the teaching of this Court that the function of the federal judiciary "is to construe and enforce the Constitution and laws of the land as they are and not to legislate social policy on the basis of our own personal inclinations." *Evans* v. *Abney*, 396 U.S. 435, 447.

In the absence of a clear Congressional intent to preempt state law in this area—and no such intent, as set forth above, can validly be inferred from the language of Section 10(b)—we submit that the court below erred in overriding the state policy judgments embodied in the Delaware statute. As was observed by one recent commentator (Note, 89 Harv.L.Rev. 1917, 1928-9 (1976)):

> "As the *Green* opinion concedes, rule 10b-5 was not intended to be a panacea for all corporate ills. Yet if the definition of fraud under section 10(b) can be expanded to include federal common law concepts of breach of fiduciary duty and waste, it is difficult to

see what significant corporate ills remain for treatment by the states. For not only do the federal courts have exclusive jurisdiction over enforcement of 10b-5 claims, but also the substantive and procedural advantages of a federal forum to plaintiffs make it likely that virtually every suit for common law violations would gravitate to the federal courts. Surely, the 1934 Act did not contemplate confining state regulation of corporate behavior to those few cases in which mismanagement is accomplished wholly apart from any securities transaction." [footnotes omitted]

Further, the amorphous federal rule of "fiduciary duty," created by the court below to supplant the contrary law of Delaware on this point, intrudes into an especially inappropriate area. "It is one thing for federal courts to enforce recognized, state-created fiduciary duties but quite another for them to create new fiduciary duties." Borden, *Going Private—Old Tort, New Tort or No Tort?,* 49 N.Y. U.L. Rev. 987, 1037 (1974). As was stated in a widely-cited opinion by the New York Court of Appeals, "[t]he primary source of the law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 503-4 (1969).

This Court recently had occasion to consider the *Diamond* case, in connection with another venture by the Second Circuit into the creation of corporate common law. In *Lehman Brothers* v. *Schein,* 416 U.S. 386, a derivative claim was asserted on behalf of a Florida corporation, against persons who had allegedly traded in the corporation's securities on the basis of non-public information. The New York courts had held in the *Diamond* case that, under New York law, a fiduciary who profited from the use of non-public information could be liable directly to the corporation; plaintiffs in the *Lehman Brothers* action sought to extend such liability to outsiders who acted in concert with fiduciaries. The Second Circuit, while rec-

ognizing that the Florida courts had not passed upon the issue, held that the rule advocated by plaintiffs should be adopted, as a further deterrent to insider trading. This Court reversed, holding that the Court of Appeals should have certified the question to the Florida Supreme Court, under a procedure made available by a Florida statute. With respect to the Second Circuit's discussion on the merits of the proposed rule, this Court observed (416 U.S. at page 389):

> "Such a construction of *Diamond,* the Court of Appeals said, would have 'the prophylactic effect of providing a disincentive to insider trading.' *Id.,* at 823. And so it would. Yet under the regime of *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), a State can make just the opposite her law, providing there is no overriding federal rule which pre-empts state law by reason of federal curbs on trading in the stream of commerce."

By promulgating a new federal rule of "fiduciary duty," in disregard of the applicable state law, the court below has in effect revived the discredited doctrine of *Swift* v. *Tyson,* 41 U.S. (16 Pet.) 1, and has recreated a federal common law of corporations, which would apparently supplant, to a still undefined extent, the substantive corporate law of the states. The dangers of creating federal common law in this area were forcefully stated by Borden, *Going Private—Old Tort, New Tort or No Tort?,* 49 N.Y.U.L. Rev. 987 (1975). After recalling the unfortunate developments under the doctrine of *Swift* v. *Tyson,* Professor Borden noted (49 N.Y.U.L. Rev. at page 1039):

> "If the federal securities laws are to be pushed so far beyond their original purpose as not only to enforce recognized standards of fiduciary obligations but to create new ones in a hotly debated area without deference to state law or empirical study or any balancing of the numerous competing social interests involved, one may suppose that one day there will again be a

> recognition of the 'mischievous result' of judicial law-making based upon an alleged 'transcendental body of law outside of any particular State' which federal courts in their good judgment may discern and apply. We will then have in the securities field our own *Erie* v. *Tompkins*." [footnotes omitted]

One "mischievous result" of the majority's decision is already apparent, in addition to its disregard of the balance between federal and state regulatory authority. As noted above, the concepts of federal "fiduciary duty" and "corporate purpose" announced by the majority are as ill-defined as they are lacking in authority. State corporation statutes have uniformly recognized, by the explicitness of their terms, that the obligations imposed by law on the corporation should be known with certainty. Under the decision of the Court of Appeals, corporate management can no longer rely on meticulous compliance with state corporate statutes, as an assurance that their actions will be lawful: the court below has held such compliance, in the complete absence of deception or nondisclosure, may constitute a "fraud" under Rule 10b-5, if it is later found contrary to a federal court's still-undefined concept of "fiduciary duty."

Moreover, the decision below makes it clear that this result will not be limited to short form mergers. In passing, the majority opinion notes (533 F.2d at page 1292) that other actions by majority shareholders may also be subject to *ad hoc* federal review, again in the absence of misrepresentation and nondisclosure: the majority concludes, almost casually, that this further expansion is "for another day." The uncertainty implied in this formulation is clearly in conflict with one major policy behind all state corporation statutes. To override a specific policy judgment of the state legislature, without a clear Congressional mandate, was a serious error on the part of the court below. To create widespread uncertainty and confusion in state

corporate regulation, similarly without any authority from Congress, is a still more serious error. Petitioners submit that this Court should not permit the resurrection of *Swift* v. *Tyson* in this area, and that the "mischievous results" of the lower court's action should be checked in their incipiency.

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals with respect to petitioners should be reversed, and remanded with instructions to dismiss the amended complaint.

Respectfully submitted,

William R. Glendon
Attorney for Petitioners
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

Of Counsel:

Rogers & Wells
Robert D. Larsen
Guy C. Quinlan
Gene M. Bauer

Appendix—Constitutional Provisions, Statutes and Regulations

UNITED STATES CONSTITUTION AMENDMENT X

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULE 10b-5

§ 240.10b—5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. (Sec. 10; 48 Stat. 891; 15 U.S.C. 78j) [13 F.R. 8183, Dec. 22, 1948, as amended at 16 F.R. 7928, Aug. 11, 1961]

DELAWARE CORPORATION LAW

§ 253. Merger of parent corporation and subsidiary or subsidiaries

(a) In any case in which at least 90 percent of the outstanding shares of each class of the stock of a corporation or corporations is owned by another corporation and one of such corporations is a corporation of this State and the other or others are corporations of this State or of any other state or states or of the District of Columbia and the laws of such other state or states or of the District permit a corporation of such jurisdiction, to merge with a corporation of another jurisdiction, the corporation having such stock ownership may either merge such other corporation or corporations into itself and assume all of its or their obligations, or merge itself, or itself and one or more of such other corporations, into one of such other corporations by executing, acknowledging and filing, in accordance with section 103 of this title, a certificate of such ownership and merger setting forth a copy of the resolution of its board of directors to so merge and the date of the adoption thereof; provided, however, that in case the parent corporation shall not own all the outstanding stock of all the subsidiary corporations, parties to a merger as aforesaid,

the resolution of the board of directors of the parent corporation shall state the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation. If the parent corporation be not the surviving corporation, the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor, and the certificate of ownership and merger shall state that the proposed merger has been approved by a majority of the outstanding stock of the parent corporation entitled to vote thereon at a meeting thereof duly called and held after 20 days' notice of the purpose of the meeting mailed to each such stockholder at his address as it appears on the records of the corporation. A certified copy of the certificate shall be recorded in the office of the Recorder of the County in this State in which the registered office of each constituent corporation which is a corporation of this State is located. If the surviving corporation exists under the laws of the District of Columbia or any state other than this State, the provisions of section 252(d) of this title shall also apply to a merger under this section.

(b) If the surviving corporation is a Delaware corporation, it may change its corporate name by the inclusion of a provision to that effect in the resolution of merger adopted by the directors of the parent corporation and set forth in the certificate of ownership and merger, and upon the effective date of the merger, the name of the corporation shall be so changed.

(c) The provisions of Section 251(d) of this title shall apply to a merger under this section, and the provisions of Section 251(e) shall apply to a merger under this section in which the surviving corporation is the subsidiary corpo-

ration and is a corporation of this State. Any merger which effects any changes other than those authorized by this section or made applicable by this subsection shall be accomplished under the provisions of Section 251 or Section 252 of this title. The provisions of Section 262 of this title shall not apply to any merger effected under this section, except as provided in subsection (d) of this section.

(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the surviving corporation shall, within 10 days after the effective date of the merger, notify each stockholder of such Delaware corporation that the merger has become effective. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any such stockholder may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation payment of the value of his stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If during a period of 30 days after such period of 20 days the surviving corporation and any such objecting stockholder fail to agree as to the value of such stock, any such stockholder or the corporation may file a petition in the Court of Chancery as provided in subsection (c) of section 262 of this title and thereupon the parties shall have the rights and duties and follow the procedure set forth in subsections (d) to (j) inclusive of section 262.

(e) A merger may be effected under this section although one or more of the corporations parties to the merger is a corporation organized under the laws of a jurisdiction other than one of the United States; provided that the laws of such jurisdiction permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction; and provided further that the surviving or resulting corporation shall be a corporation of this State.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

§ 262. Payment for stock or membership of person objecting to merger or consolidation

(a) When used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a non-stock corporation.

(b) The corporation surviving or resulting from any merger or consolidation shall within 10 days after the effective date of the merger or consolidation, notify each stockholder of any corporation of this State so merging or consolidating who objected thereto in writing and whose shares either were not entitled to vote or were not voted in favor of the merger or consolidation, and who filed such written objection with the corporation before the taking of the vote on the merger or consolidation, that the merger or consolidation has become effective. Such notice shall likewise be given to each stockholder whose corporation approved the merger or consolidation pursuant to section 228 of this title without a meeting of its stockholders and who either did not, or had no right to, consent in writing to such merger or consolidation. If any such stockholder shall within 20 days after the date of mailing of the notice demand in writing, from the corporation surviving or resulting from the merger or consolidation, payment of the value of his stock, the surviving or resulting corporation shall, within 30 days after the expiration of the period of 20 days, pay to him the value of his stock on the effective date of the merger or consolidation, exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation.

(c) If during a period of 30 days following the period of 20 days provided for in subsection (b) of this section, the corporation and any such stockholder fail to agree upon the value of such stock, any such stockholder, or the corporation surviving or resulting from the merger or consolidation, may, by petition filed in the Court of Chancery within four months after the expiration of the period of 30 days, demand a determination of the value of the stock of all such stockholders by an appraiser to be appointed by the Court.

(d) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the corporation, which shall within ten days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the corporation. If the petition shall be filed by the corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the corporation and to the stockholder shown upon the list at the addresses therein stated, and notice shall also be given by publishing a notice at least once at least one week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware. The Court may direct such additional publication of notice as it deems advisable. The forms of the notices by mail and by publication shall be approved by the Court.

(e) After the hearing on such petition the Court shall determine the stockholders who have complied with the provisions of this section and become entitled to the valuation of and payment for their shares, and shall appoint an appraiser to determine such value. Such appraiser may examine any of the books and records of the corporation or corporations the stock of which he is charged with the duty

of valuing, and he shall make a determination of the value of the shares upon such investigation as to him seems proper. The appraiser shall also afford a reasonable opportunity to the parties interested to submit to him pertinent evidence on the value of the shares. The appraiser, also, shall have such powers and authority as may be conferred upon masters by the rules of the Court of Chancery or by the order of his appointment.

(f) The appraiser shall determine the value of the stock of the stockholders adjudged by the Court of Chancery to be entitled to payment therefor and shall file his report respecting such value in the office of the Register in Chancery and notice of the filing of such report shall be given by the Register in Chancery to the parties in interest. Such report shall be subject to exceptions to be heard before the Court both upon the law and facts. The Court shall by its decree determine the value of the stock of the stockholders entitled to payment therefor and shall direct the payment of such value, together with interest, if any, as hereinafter provided, to the stockholders entitled thereto by the surviving or resulting corporation upon the transfer to it of the certificates representing such stock, which decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other state.

(g) At the time of appointing the appraiser or at any time thereafter the Court may require the stockholders who demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, and if any stockholder fails to comply with such direction the Court may dismiss the proceedings as to such stockholder.

(h) The cost of any such appraisal, including a reasonable fee to and the reasonable expenses of the appraiser, but exclusive of fees of counsel or of experts retained by

any party, may on application of any party in interest be determined by the Court and taxed upon the parties to such appraisal or any of them as appears to be equitable, except that the cost of giving the notice by publication and by registered mail hereinabove provided for shall be paid by the corporation. The Court may, on application of any party in interest, determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto.

(i) Any stockholder who has demanded payment of his stock as herein provided shall not thereafter be entitled to vote such stock for any purpose or be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation) unless the appointment of an appraiser shall not be applied for within the time herein provided, or the proceeding be dismissed as to such stockholder, or unless such stockholder shall with the written approval of the corporation deliver to the corporation a written withdrawal of his objections to and an acceptance of the merger or consolidation, in any of which cases the right of such stockholder to payment for his stock shall cease.

(j) The shares of the surviving or resulting corporation into which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

(k) This section shall not apply to the shares of any class or series of a class of stock, which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation is to be acted on, were either (1) listed on a national securities exchange, or (2) held of record by more than 2,000 stockholders, unless

the certificate of incorporation of the corporation issuing such stock shall otherwise provide; nor shall this section apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of Section 251 of this title. This subsection shall not be applicable to shares of any class or series of a class of stock of a constituent corporation if under the terms of a merger or consolidation pursuant to Section 251 or Section 252 of this title the holders thereof are required to accept for such stock anything except (a) shares of stock or shares of stock and cash in lieu of fractional shares of the corporation surviving or resulting from such merger or consolidation; or (b) shares of stock or shares of stock and cash in lieu of fractional shares of any other corporation, which at the effective date of the merger or consolidation will be either (1) listed on a national securites exchange or (2) held of record by more than 2,000 stockholders; or (c) a combination of shares of stock or shares of stock and cash in lieu of fractional shares as set forth in (a) and (b) of this subsection.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

FOR ARGUMENT

IN THE

Supreme Court of the United States

OCTOBER TERM 1976

No. 75-1753

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC. and KIRBY LUMBER CORPORATION,

Petitioners,

against

S. WILLIAM GREEN, *et al.*,

Respondents.

BRIEF ON BEHALF OF RESPONDENTS

SIDNEY BENDER
Attorney for Respondents
405 Lexington Avenue
New York, New York 10017
Tel. No. (212) 986-4080

Of Counsel:

AARON LEWITTES

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Constitutional Provisions, Statutes and Regulations

In addition to the statutes and regulations set forth in the Appendix to the Petitioners' Brief ("PBr"), particularly Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act") and Rule 10b-5 thereunder, involved herein are Article VI, clause 2 of the U.S. Constitution (the supremacy clause) and Section 17(a) of the Securities Act of 1933 ("1933 Act").

Article VI cl. 2, of the U.S. Constitution, insofar as pertinent, reads as follows:

Clause 2. Supreme Law of Land

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall

be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 17(a) of the 1933 Act reads as follows (15 U.S.C. § 77q):

§ 77q. Fraudulent interstate transactions

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

The Question Presented

A fiduciary, owning 95% of its subsidiary's stock, with knowledge from appraisals it had made that such stock was worth at least $772 per share, deliberately undervalued it and unilaterally fixed the price at $150 per share in a secret forced purchase from the 5% minority; the device it used for the purpose was a short form merger with a paper corporation, thereby intentionally misappropriating $15,000,000 from its cestui shareholders: is

that deception, manipulation or fraud within Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder?*

Statement of the Case

This is a derivative action in behalf of Kirby Lumber Corporation, a Delaware corporation ("Kirby"), and a class action in behalf of its minority stockholders. The latter include plaintiffs whose Kirby stock is alleged to be worth over $110,000. Kirby was controlled and dominated by defendant Santa Fe Industries, Inc. and the latter's wholly owned subsidiary, defendant Santa Fe Natural Resources, Inc. (jointly "Santa Fe"). Santa Fe, which owned 95% of Kirby's stock was a fiduciary; Kirby and its minority stockholders Santa Fe's cestuis (122a).**

The complaint alleged the following fraudulent manipulative or deceptive scheme. In order deliberately to freeze the minority stockholder cestuis out of Kirby at a fraction of their true interest, Santa Fe, their faithless fiduciary, resorted to a Delaware short-form merger having no other substantial purpose. Santa Fe organized a dummy corporation which was then immediately merged into Kirby without prior notice to the stockholders. The minority in a fait accompli were allotted $150 cash per share for their stock, an intentionally undervalued price, unilaterally determined by Santa Fe which knew from its own appraisal that the stock was worth at least $772.00 per share (102a-103a, 142a, fn. 2). Santa Fe, the fiduciary, deliberately pocketed the difference, some $15,000,000.

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* Presence of the other ingredients of a 10b-5 violation (purchase-sale of a security via mails and interstate commerce) is not contested.

** Citations to "(a)" are to the separately bound Appendix filed by Petitioners.

There is no dispute as to the underlying facts.* In a nutshell:

(1) Appraisal Associates on February 19, 1974 had submitted to Santa Fe a written appraisal of the land (exclusive of minerals), timber, buildings and machinery belonging to Kirby as of December 31, 1973, stating its *market value to be $320,000,000* (102a, 128a, 82a-84a), *a critical fact completely omitted from petitioners' brief.* The *book value* of these assets was only $9,000,000. The difference of $311,000,000 was $622 per share over and above the book value of those assets of Kirby (102a). Adding the omitted market value of $622 per share to the $150 per share yields a fair value of $772 per share for Kirby's physical assets; the stock was worth at least that amount (102a).

(2) Sante Fe, as part of the scheme to defraud the minority stockholders of Kirby and with full knowledge of Appraisal Associates' opinion of the market value of Kirby's assets, obtained from defendant Morgan Stanley & Co. ("Morgan") in June 1974 a fraudulent appraisal valuing Kirby's stock at $125 per share (103a). Morgan was joined as a defendant with the allegation that it knowingly assisted and facilitated such fraud by submitting a written appraisal of the stock at $125 per share even though it reviewed the written appraisal by Appraisal Associates for $320,000,000 and knew the value of Kirby was at least $772 per share (103a, 80a-81a).** Santa Fe in a self deal fixed the value of the Kirby minority shares at $150 per share in order to create the erroneous appearance that it was generous in fixing a value $25 higher than the Morgan appraisal (103a).

* The case is at the earliest pleading stage, there having been no answer and no pre-trial discovery. The plaintiffs' claim is set forth in the amended complaint as enlarged by the Sante Fe Information Statement with its enclosures, sent to the stockholders *after* the merger (122a). Plaintiffs' allegations of fact and the reasonable inferences therefrom are, of course, taken to be true on the motion to dismiss; e.g., *Supt. of Insur.* v. *Bankers Life*, 404 U.S. 6; *Gardner* v. *Toilet Goods Ass'n*, 387 U.S. 167, 172.

** The Court of Appeals affirmed the dismissal as to Morgan; plaintiffs' petition for certiorari is now pending as Docket No. 75-1660.

(3) In addition, Santa Fe arranged the transaction as tax-free to itself while imposing a capital gains tax on the Kirby minority stockholders (102a).

(4) For the sole purpose of getting rid of the minority interest in Kirby and not for any substantial corporate purpose, Santa Fe created Forest Products Inc. ("FPI"), a Delaware corporation, on July 11, 1974, to effect a statutory merger with Kirby under the color of the Delaware short form merger statute which authorized effectuation of the merger before notice to and without consent of the minority, and provision of payment in cash for the minority.

(5) *Without any notice or disclosure whatsoever to the minority stockholders of Kirby, or consent by them,* Santa Fe, on July 31, 1974, caused FPI to be merged into Kirby, freezing out the minority, with Kirby surviving the merger (100a). Kirby's purchase at $150 per share on July 31, 1974 was a forced sale by the minority to the fiduciary on that date, without even the knowledge of such minority stockholders (101a).

(6) By letter of August 1, 1974, *after** the merger had been completed effective the previous day, the minority stockholders of Kirby were *first* informed by Santa Fe that their only right was to receive a cash payment of $150 per share for their shares that were purchased by Kirby on July 31, 1974 or to seek an appraisal under Dela-

* The Court of Appeals, inadvertently at one point (129a), stated that the Information Statement was sent to the shareholders *"prior* to the merger" (129a), other parts of the opinion recognize the undisputed fact that it was sent *"after"* the merger *(passim)* (Emphasis supplied throughout unless otherwise noted).

ware law for the fair value of those shares (101a). Kirby's letter of August 1st to the stockholders consisted of the Notice of Merger of FPI, Inc. into Kirby (12a-14a) and an Information Statement about the merger (15a-98a). That Information Statement, *inter alia,* incorporated the written appraisal of Appraisal Associates for $320,000,000 (82a-84a) and Morgan's opinion that the fair market value of the Kirby stock was $125 per share (80a). Santa Fe submitted the Morgan appraisal to the stockholders in an attempt to disguise the unconscionableness of the $150 price. The Information Statement, which was the basis for plaintiffs' allegations in the amended complaint, in effect announced the fraud that had been consummated the previous day. Santa Fe's confession of the fraud, post the event, did not grant it immunity from suit under the 1934 Act. It does not matter whether the fraud is unearthed by minority stockholders or published by the faithless fiduciary. Disclosure in the context of Rule 10b-5(2) means *prior* to the merger, not after it. Judge Mansfield, in his concurring opinion, stated (148a):

> Here . . . disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out (original emphasis).

This is not a case where plaintiffs merely allege that in their opinion the market value of the stock was $772. On the contrary, plaintiffs' allegation of fair value is based on defendants' own written market appraisal of $320,000,000 for certain assets. With that knowledge, Santa Fe deceived and defrauded the 5% minority stockholders by intentionally* undervaluing their shares at

* The intent to deceive, defraud, or manipulate is easily inferred from the knowing, gross disparity in price the fiduciary fixed, for its own advantage to its cestuis' prejudice, and from its abuse of a form with no purpose other than to misappropriate their property.

$150 in a concealed forced sale by the minority stockholders to Kirby, through an abuse of Delaware's short form merger statute. That was also an intentional breach of Santa Fe's fiduciary duty. The fiduciary thus created a scheme under color of state law to deliberately misappropriate its cestuis' property in a security purchase-sale, to the tune of $15,000,000 (103a), without the knowledge or consent of the stockholder-beneficiaries and without prior notice of any kind to them.

The above transaction, whereby the dominant stockholder, a fiduciary, fleeced the minority, its cestuis, in the purchase and sale of securities, implemented by the use of means or instrumentalities of interstate commerce including U.S. mail and telephone (103a) constituted a plain violation of Rule 10b-5 under the settled authorities. It disclosed Santa Fe's flagrant "intent to deceive, manipulate, or defraud" its cestuis in the stock acquisition, striking at the heart of Section 10(b) of the 1934 Act and SEC Rule 10b-5 thereunder, *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (103a).

The complaint asked that the merger be set aside and/or for other appropriate relief such as the fair value of the minority shares.

Defendants moved in the District Court, pursuant to Rules 12(b)(1) and (6), F.R.Civ.P., to dismiss the complaint for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted. The District Court granted this motion and therefore did not reach the alternative motion under Rule 9(b) to dismiss the complaint for alleged failure to state the fraud with sufficient particularity.

Appeal to the Court of Appeals duly followed. The Panel (Medina, Moore, and Mansfield, C.J.J.) reversed the District Court's dismissal of the complaint against Santa Fe (Moore, J. Diss'g), Santa Fe's petition for rehearing

en banc was denied. The Court of Appeals summarized its holding as follows (134a):

> We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement.

Summary of Argument

The Court below correctly held that it was deception, manipulation, or fraud, within Section 10(b) of the 1934 Act and Rule 10b-5 thereunder, where the fiduciary appropriated its cestuis' stock through the abuse of a short form merger, without any purpose other than to mulct its cestuis, and without their knowledge or consent, willfully setting an unfair price at $150 per share although knowing from appraisals it caused to be made that the stock was worth at least $772 per share. This misappropriation is "a garden variety type of fraud" covered by Rule 10b-5. *Supt. of Insur.* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 11, n. 7, and numerous cases in the lower federal courts, as well as the common law tradition of fraud set forth by the Supreme Court e.g. in *SEC* v. *Capital Gains Bur.*, 375 U.S. 180, 193, and other authorities. Section 10(b) and Rule 10b-5, as shown by its language and history and legislative purpose, is not confined to misrepresentations and non-disclosure. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185. Moreover, the fraud here included both misrepresentation and non-disclosure.

Since the manifest language and purpose of Section 10(b) and Rule 10b-5 is to cover all fraudulent misconduct in the purchase or sale of securities, embodying the "paramount federal interest in protecting shareholders", *SEC* v. *Natl. Securities, Inc.,* 393 U.S. 453, 463, and pursuant to the purpose of Congress to establish a "federal regulatory scheme governing transactions in securities" affecting commerce, *Ernst & Ernst, supra,* at 206, the federal courts will enforce the Rule "flexibly, not technically and restrictively" *Supt. of Insur., supra,* at 12, as the supreme law of the land, without regard to more limited state rules or remedies. *Supt. of Insur., supra,* at 12; *National Securities, supra,* at 463. Moreover, following a state procedure does not immunize fiduciaries if they abuse it, as "their powers are powers in trust", *Pepper* v. *Litton,* 308 U.S. 295, 306. The abuse of a state form can provide no defense for the violation of the substance sought to be protected by state law, *Graffam* v. *Burgess,* 117 U.S. 180, 186, and *a fortiori* by the federal enactment. *Supt. of Insur., supra.*

ARGUMENT

The transaction was an intentional deception, manipulation or fraud within Rule 10b-5 under Section 10(b) of the 1934 Act.

The purpose of Santa Fe's purchase of securities from the minority stockholders of Kirby in a forced sale was an intentional appropriation by the fiduciary of its cestuis' property at a price unilaterally fixed by the fiduciary and known by the fiduciary to be only a small fraction of its true value. Hence there is no doubt that the standard of *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 of intent to defraud, manipulate or deceive has been met and Rule 10b-5 under Section 10(b) of the 1934 Act applies.

Section 17(a) of the 1933 Act

The language and purpose of Section 17(a) of the 1933 Act demonstrate that the transaction was in violation of the parallel Rule 10b-5 under Section 10(b) of the 1934 Act.

Section 17(a) expressly prohibits the sale of securities by means of (1) "any device, scheme, or artifice to defraud" or (2) "any untrue statement of a material fact or any [material] omission" or (3) "any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser". Since clause (2) expressly includes misrepresentations and omissions, it is evident that Congress in enacting clauses (1) and (3) intended to cover frauds or deceptions that might not come under the category of misrepresentations or omissions. This is also borne out by the use of phrases like "any device, scheme or artifice" or "transaction, practice or course of business", phrases which by their ordinary meaning include misconduct other than statements or silence.

That Section 17(a) is not confined to misrepresentations and non-disclosure is also borne out by the overall purpose of the 1933 Act. As stated in *Ernst & Ernst, supra,* 425 U.S., at 194-195:

> Federal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929. The . . . 1933 Act . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, *to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing.*

A comparison of Section 17(a) with Section 11(a) and Section 12(2), the other antifraud provisions of the 1933 Act, further demonstrates that Section 17(a) goes beyond

misrepresentations and non-disclosure. Both Sections 11(a) and 12(2) cover only misrepresentations and omissions, which are covered by clause (2) of Section 17(a); and neither Section 11(a) nor Section 12(2) has any clause similar to clauses (1) and (3) of Section 17(a).*

Rule 10(b)(5), First and Third Clauses

With the two narrow antifraud provisions and one comprehensive antifraud provision, which included three enumerated clauses, of the 1933 Act before it in the consideration and enactment of the 1934 Act, Congress, rejecting the narrow approach, enacted the broad antifraud provision of Section 10(b) but without the enumeration of the specific clauses of Section 17(a) of the 1933 Act. Instead of that specific enumeration Congress in Section 10(b) authorized the SEC to enumerate specific instances of manipulative and deceptive devices. As the Supreme Court has noted, the legislative history of Section 10(b) shows it was intended as a "catch-all", to proscribe "any other cunning devices" that operate as a fraud in connection with the purchase and sale of securities, *Ernst & Ernst, supra,* 425 U.S., at 202 and 203. If Congress had intended to confine the antifraud provisions of Section 10(b) to misrepresentation and non-disclosure, it is evident that it would not have used a catch-all provision, but would have reenacted the narrow antifraud provisions of Sections 11(a) and 12(2) of the 1933 Act and the Court in *Ernst & Ernst* throughout its

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* Section 11(a) (15 U.S.C. § 77k(a)) proscribes a registration statement containing "an untrue statement of a material fact or [one that] omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."

Section 12(2) (15 U.S.C. § 77l) proscribes the sale of a security by a "communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading".

opinion referred to 'deception, manipulation or fraud' and to words like 'practices' and conduct'—all terms which are more comprehensive than misrepresentation and omission.

The SEC, under the authority of Section 10(b), issued Rule 10b-5 which is virtually identical with the three specific clauses of Section 17(a) of the 1933 Act. See *Ernst & Ernst, supra,* 425 at 213, n. 32.* It is entirely clear therefore that Section 10(b) with Rule 10b-5 was intended to have at least as broad a scope as Section 17(a) of the 1933 Act, but applicable to purchasers as well as sellers of securities.

This Court's opinion in *Ernst & Ernst* stated, with respect particularly to Section 10(b), that

> Congress recognized that efficient regulation of securities trading could not be accomplished under a rigid statutory program. As part of the 1934 Act Congress created the Commission, which is provided with an arsenal of flexible enforcement powers (425 U.S., at 195).

As with 17(a) of the 1933 Act, Rule 10b-5 clause 2 expressly includes misrepresentations and omissions, so that clauses 1 and 3 plainly refer to frauds that need not constitute misrepresentation or omission.

The opinion in *Ernst & Ernst* gives further support to the position that Section 10(b) is not confined to misrepresentation or non-disclosure.** Thus the Court stated (*id.* at 197) as follows:

> Section 10(b) makes unlawful the use or employment of "any manipulative or deceptive device or contrivance" in contravention of Commission rules. The words "manipulative or deceptive" used in conjunction with "device or contrivance" strongly suggest that Section 10(b) was intended to proscribe knowing or intentional *misconduct.*

Clearly this language cannot be restricted to misreprentations or omissions to state.

The Court further stated as follows (*id.* at 199):

> Use of the word "manipulative" is especially significant . . . It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.

That describes precisely what the defendants did in our case. As fiduciaries they engaged in intentional or willful conduct designed to deceive or defraud their cestuis by controlling the price of the securities, unilaterally fixing the price at which they knowingly misappropriated the stock at 20% of its value, to their manifestly unfair advantage and to the prejudice of the stockholders.*

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* 10b-5 was in fact originally inspired by purchasers' fraudulent and deceitful activities related to an upswing in the economy and to consequent takeovers by insiders of their cestuis' equity (*Ernst & Ernst, supra,* at 212-213, n. 32; 1 Bromberg, Securities Law—Fraud pp. 22.8-22.9).

** Indeed, what was complained of against the defendant Ernst & Ernst was the breach of a duty to inquire (*id.* at 191) which

(footnote continued on following page)

(footnote continued from preceding page)

is neither misrepresentation nor non-disclosure; the Court implicitly held that an intentional failure to inquire, for the purpose of manipulation, fraud or deception would have been a violation of Section 10(b) and Rule 10b-5.

* The "*Schoenbaum* court [405 F2d 215 (2d Cir. *en banc*)] appears to have recognized, as the securities laws in other areas have recognized, that it is possible to manipulate transactions, not only through deception and the withholding of material information, but also through the use of controlling influence. Thus the *Schoenbaum* court's holding that the use of controlling influence in a corporation can be an 'act, practice or course of business which operates . . . as a fraud' seems to be a realistic interpretation of rule 10b-5." Note, *The Controlling Influence*

(footnote continued on following page)

The Court also quoted from Webster's Int'l Dictionary, which, in part, defines "manipulate" as ". . . to manage or treat artfully or fraudulently" *id.* at 199, n.21. The conduct complained of here falls squarely within that definition, in that the fiduciary defendants managed their power over their beneficiaries' stock fraudulently.

The Court in *Ernst & Ernst* stated further (*id.*, at 206):

> The Report therefore reveals with respect to the specified practices, an overall congressional intent to prevent "manipulative and deceptive practices . . . which fulfill no useful function" and to create private actions for damages stemming from "illicit practices" where the defendant has not acted in good faith.

Again, this language aptly describes the misconduct complained of in our case.

The Court in *Ernst & Ernst* in its brief discussion of the three clauses of Rule 10b-5 taken severally (at 212) characterized subsection 2 as proscribing "any type of material misstatement or omission" and subsection 3 as proscribing "any course of conduct, that has the effect of defrauding investors"—an explicit recognition that clause 3 goes beyond clause 2 in proscribing fraudulent conduct other than misrepresentation or non-disclosure.

Finally, the Court in *Ernst* noted (id., at 212):

> that when the Commission adopted the rule it was intended to apply only to *activities* that involved scienter.

(footnote continued from preceding page)

Standard In 10b-5 Corporate Mismanagement Cases. 86 Harv. L. Rev. 1007, 1036. The Court below explained the *Schoenbaum* decision as follows (132a): "Breach of fiduciary duty and fraud on the *cestuis* and the corporation had been committed, on the facts as alleged, when Banff sold its shares to Aquitaine at an inordinately low price after the directors had learned of the important oil discovery and before that information had been made public, even though there had been neither misrepresentation nor failure to make any required disclosure to the minority."

"Activities", as the enumeration of the three clauses shows, included (clause 2) misrepresentations and non-disclosure and (clauses 1 and 3) also included any other kind of fraud practiced upon purchasers or sellers of securities.*

Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act with Rule 10b-5 thereunder must of course be construed together in the light of their common purpose. In *Ernst & Ernst,* this Court referred to "the overall congressional purpose in the *1933 and 1934 Acts* to protect investors against false and deceptive *practices* that might injure them." 425 U.S., at 198.** The Court stated further, *id.* at 206, in this connection as follows:

> The 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities . . . the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen . . .

Plainly Section 10(b) and Rule 10b-5 are not to be interpreted any more narrowly than the comprehensive antifraud provision of Section 17(a) of the 1933 Act.

* The Court in *Ernst,* noting the use of the word "device" in Section 10(b) and clause 1 of Rule 10b-5, quoted (*id.* at 199, n. 20) Webster's Int'l Dictionary definition of "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice". The Court, continuing, quoted Webster's definition of "contrivance", used in Section 10(b), as "[a] thing contrived, or used in contriving; a scheme, plan, or artifice." "In turn, 'contrive' in pertinent part is defined as '[t]to devise; to plan; to plot . . . [t]o fabricate . . . design; invent . . . to scheme . . .'". The Court also noted the use of the terms in Section 10(b) "[t]o use or employ". The corresponding words are, in clause 1 "to employ" and in clause 3 "to engage". These terms, of course, aptly refer broadly to misconduct that is not limited to misrepresentation and non-disclosure.

** Accord: *United Housing Found.* v. *Forman,* 421 U.S. 834, 847; *Radzanower* v. *Touche, Ross & Co.,* —— U.S. ——, 48 L.Ed.2d 540, 547.

The Supreme Court has already held that Rule 10b-5 goes beyond statements and silence to other fraudulent practices by a fiduciary in the purchase or sale of securities. *Supt. of Insurance* v. *Bankers Life,* 404 U.S. 6 applied the 1st and 3rd clauses of Rule 10b-5 which proscribe nonverbal frauds (404 U.S., at 9) and held that "misappropriation is a 'garden variety' type of fraud" *id.* at 11, n. 7, within the language and contemplation of the Rule and Section 10(b). That case squarely applies to ours. The only difference is that there the fiduciary pocketed all the proceeds and here the fiduciary misappropriated "only" 80% of the value of its cestuis' stock, some $15,000,000. In *Sup't of Insurance,* the Court stated, too, that "The Congress made clear that 'disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless webb' along with manipulation, investor's ignorance, and the like." (404 U.S., at 11-12).

Likewise, in *Affiliated Ute Citizens* v. *U.S.,* 406 U.S. 128, 152-3, the Court stated:

> To be sure, the second subparagraph of the rule [10b-5] specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted.

This Court has already defined the scope of the "fraud" concept in the federal securities laws. In *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 193, the Court set forth the following as the applicable standard of what constitutes fraud for the purposes of the securities laws:

> [E]quity regarded it [fraud] as a conveniently comprehensive word for the expression of a lapse from the standard of conscientiousness that it exacted from any party occupying a certain contractual or fiduciary relation toward another party.

And the Court below (131a) cited *Capital Gains Research Bureau Inc.,* at 194, as quoting from *Moore* v. *Crawford,* 130 U.S. 122, 128 (1888):

> Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.

Plainly Santa Fe's resort to the form of a merger for the deliberate purpose of misappropriating most of the value of its cestuis' stock constitutes "fraud . . . in the sense of a . . . breach of . . . equitable [fiduciary] duty . . . by which an undue and unconscientious advantage is taken of another." Santa Fe's imposing on the minority a sale to itself, against their will, at $150 per share, the fiduciary knowing the stock's value is in excess of $772 per share, is conclusively "an undue and unconscientious advantage", an intentional breach of its fiduciary duty and thus a fraud. The Supreme Court's 1888 case of *Moore* v. *Crawford, supra,* demonstrates that a wilful breach of fiduciary duty under such circumstances is a classic case of "fraud" long established in the law. As long ago as 1850 the Supreme Court in *Taylor* v. *Taylor,* 49 U.S. 183, 199-200, quoting Mr. Justice Story's treatise on equity jurisprudence with approval, stated:

> speaking of frauds which "arise from some peculiar confidence or fiduciary relation between the parties", he remarks, In this class of cases there is often found some intermixture of deceit, imposition, overreaching, unconscionable advantage, or other mark of direct and positive fraud. But the principle on which courts of equity act in regard thereto stands independent of any such ingredients, upon a motive of public policy . . . [namely that the fiduciary seeks] to derive advantage from that circumstance.

The Court in *Capital Gains Research Bureau* held at 181, *inter alia,* that scalping is a species of fraud.* In that case, involving specifically the Investment Advisers Act, the defendant argued that non-disclosure was not prohibited by the relevant provision, 15 U.S.C. § 80b-6, because that section, which contains clauses similar to clauses (1) and (3) of Section 17(a) of the 1933 Act, does not contain a misrepresentation or non-disclosure clause such as clause (2) of section 17(a).** The Supreme Court, rejecting that argument, stated that *"any practice* which operates 'as a fraud or deceit'" includes non-disclosure "as *one* variety" thereof (198-199).

Moreover, even at common law,*** fraud is not confined to misstatements or omissions to state.**** Thus, the

* Scalping is purchasing a security shortly before recommending it and selling immediately after—a practice that need not involve misstatements to the victim or non-disclosure; i.e., omission from a statement to him.

** Section 80b-6 refers to fraud or deception by "any device, scheme or artifice" or "any transaction, practice or course of business".

*** ". . . the courts have adapted the common law of fraud to the commercial transactions of our society." *Capital Gains Research Bureau, supra,* 375 U.S., at 192. Of course, there is "some relationship" between the statutory anti-fraud provisions and the common law. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 724.

**** e.g. 12 Williston on Contracts (Jaeger ed.), pp. 321-2, 330-1, 332; Bouvier's Law Dict. (Rawle's Third Rev.), entry "FRAUD": it includes "any cunning, deception, or artifice, used to circumvent, cheat, or deceive another." As Prosser stated in discussing fraud by conduct, "actions may speak louder than words." *Torts* (4th ed., 1971) pp. 694-5.

The first meaning of "fraud" in the Random House Dict. of the Eng. Lang. (Unab. Ed.) p. 564, is "1. deceit, trickery, sharp practice, or breach of confidence, used to gain some unfair or dishonest advantage."

As long ago as 1201, a writ of deceit could be sued out against a defendant "who had misused legal procedure for the purpose of swindling someone." Prosser *Id.,* p. 685.

fiduciary's misappropriation* of his cestui's property is, of course, also a fraud at common law, even if there were no misstatements or omissions to state. *Grin* v. *Shine,* 187 U.S. 181, 189, 195.

The authorities uniformly agree that a fiduciary's taking unfair advantage of his cestui is, without more, a species of fraud at common law. E.g. Amer. Jurisp. 2d "Fraud and Deceit": action for fraud and deceit maintainable where fiduciary does not exercise "the utmost good faith in the transaction" or he obtains an unfair advantage "whether the unconscionable advantage was obtained by misrepresentation, concealment or suppression of material facts, artifice, or undue influence" (§ 15, pp. 38-39). "[I]f in a transaction between parties who stand in a relationship of trust and confidence, the party in whom the confidence is reposed obtains an apparent advantage over the other, he is presumed to have obtained that advantage fraudulently" (§ 441, p. 602). "The obtaining property or of any benefit through the medium and unconscientious abuse of influence by a person in whom trust and confidence are placed is a fraud of the gravest character." Citing *Moxon* v. *Payne* (1873), L.R. 8 Ch. 887, Kerr, (7th Ed. McDonnell & Monroe 1952) *A Treatise on the Law of Fraud and Mistake,* at pp. 185-6.**

Indeed, at common law, even in the absence of a fiduciary relationship, the "inadequacy of consideration may be so

* "Misappropriate"—"To appropriate wrongly or misapply in use, especially wrongfully and for oneself". Webster's New International Dictionary, 2nd Ed., Unabridged.

** Accord: 3 Pomeroy's Equity Jurisp. (5th ed. Symons) p. 421; Prosser on Torts (4th ed. 1971) p. 697. At common law, a strict Trustee may in no event buy his cestui's property, from himself because of the temptation to defraud (Bogert, Trusts and Trustees (2d ed.) § 543, n.2.10). *Kerr, supra,* p. 1: "The fertility of man's invention in devising new schemes of fraud is so great that the Courts have always declined to define it or to define undue influence, which is one of its many varieties . . ."

flagrant as of itself to afford a presumption of fraud." Am. Jurisp.2d, *supra,* at § 440, p. 601. Accord: 3 Pomeroy, *supra,* § 927, p. 634. "Inadequacy of consideration is therefore a badge of fraud." Kerr, *supra,* p. 365; also p. 225. If the disproportion is great enough it may furnish "decisive *evidence of fraud.*" Pomeroy *Id.* Here Santa Fe appropriated 80% of the minority's stock value. The disproportion becomes even more significant as to "the fact of fraud" because there was no "deliberation by the parties [seller and purchaser]", Pomeroy, *supra,* § 928, p. 637—Santa Fe having fixed the price unilaterally and effected the transaction for Kirby without the knowledge or consent of the public stockholders.*

As the Court below held (124a-126a):

> But only subdivision (2) of 10-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud other than and in addition to a failure to disclose or truthfully represent is also actionable. . . .
>
> As with other laws Rule 10b-5 must be interpreted and applied so as to accomplish the purpose for which it was intended. That this requires a generous reading is too obvious for comment. Since the time to which the memory of man runneth not to the contrary the human animal has been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the ordinary run of those willing and able to take unfair advantage of others are mere apprentices in the art when compared with the manipulations thought up by those connected in one way or another with transactions in securities. This is especially true of schemes that seem to be absolutely safe but offer rich rewards. In these days when there are takeovers and tender offers galore, times when those who used to think of going public now think of becoming private again, it is especially imporant to give Rule 10b-5 its full scope. If this is to be done, the enforcement of the fiduciary duty owed by the majority to the minority in corporations large and small should not be overlooked. . . .

* * * *

Judge Mansfield, concurring, stated in part as follows (144a-145a):

> . . . The short-form merger, when used to squeeze out small public investors by forcing them to relinquish their corporate investments at low prices for no purpose other than to benefit the insiders, can accurately be characterized as a "manipulative or deceptive device or contrivance," *id.* [*Supt. of Insur.,* 404 U. S.] at 10, which interferes with the interests of the public shareholders in the most fundamental of ways, by depriving the investor of his very interest in his corporate investment. It also undercuts the broader purpose of "preserving the integrity of the securities markets," *id.* at 12, for a clearer instance of potential abuse of the market processes cannot be found.

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* Accord: *Graffam* v. *Burgess,* 117 U.S. 180, 192:

> Great inadequacy requires only slight circumstances of unfairness in the conduct of the party benefiited by the sale to raise the presumption of fraud.

Kerr, supra, at p. 226:

> But inadequacy of consideration . . . becomes a most material circumstance when one of the parties to a transaction is . . . unable to protect himself. In all such cases, *whatever be the nature of the transaction,* the onus of proof rests on the party who seeks to uphold it to show that the other party performed the act or entered into the transaction voluntarily, and deliberately, knowing its nature and effect, and that his consent to perform the act or become a party to the transaction was *not* obtained by reason of any undue advantage taken of his position or of any undue influence exerted over him.

To immunize the short-form merger from the coverage of Rule 10b-5 merely because state law has authorized the device to be used for the purpose of squeezing out the public shareholders without giving them prior notice or an opportunity to obtain injunctive relief would be to ignore the central protective purposes underlying federal securities legislation and to countenance an anomalous result. Those who are most exposed and most vulnerable—the small outside public shareholders who are not privy to the inner workings of the corporate enterprise and who are forced to accept a unilaterally imposed result—would be the least protected. If they are to enjoy the protection intended to be furnished by 10b-5, that rule must not be interpreted in a technical or niggardly fashion.

Many cases in the lower courts have also found non-verbal fraudulent or deceptive acts; i.e. other than misstatements or omissions, to be violative of 10b-5, particularly in securities transactions between fiduciaries and their beneficiaries and between others in relations of confidence. E.g., *Schoenbaum* v. *Firstbrook,* 405 F2d 215 (2nd Cir., en banc), cert. den. 395 U.S. 906, inadequate price paid by controlling stockholder to corporation for stock, with inside knowledge of the true value, violates 10b-5.* Here, we

* Accord: *Drachman* v. *Harvey,* 453 F2d 736 (2nd Cir., en banc), where fiduciary knowingly caused corporation to make improvident redemption of its convertible securities, that was a violation of 10b-5; *Marshel* v. *AFW Fabric Corp.,* 533 F2d 1277 (2nd Cir.) vacated and remitted on another ground, sham merger violates 10b-5; *Mutual Shares Corp.* v. *Genesco, Inc.,* 384 F2d 540 (2nd Cir.), reduction of dividends in order to effect reduction in market price of stock violates 10b-5; *Schlick* v. *Penn-Dixie Cement Corp.,* 507 F2d 374 (2nd Cir.), cert. den. 421 U.S. 976, market manipulation violates 10b-5; *Pappas* v. *Moss,* 393 F2d 865, 869 (3d Cir.), "where, as here, a board of directors is alleged to have caused their corporation to sell its stock to them and others at a

(footnote continued on following page)

have all the necessary ingredients of a fraudulent scheme as in *Schoenbaum* (at 218-219), to wit, "control, [Santa Fe's] knowledge [of the underlying pro rata value of the physical assets of Kirby], the inadequacy of the price paid for the stock . . ." We have found no cases to the contrary.

Judge Hays had previously dissented in part from the panel's decision in *Schoenbaum,* 405 F2d 200 (C.A.2), then wrote the reversing opinion for the *en banc* Court in *Schoenbaum,* 405 F2d 215, which essentially followed his earlier dissenting panel opinion. In that earlier opinion,

(footnote continued from preceding page)

fraudulently low price, a violation of Rule 10b-5 is asserted"; *Speed* v. *Transamerica Corp.,* 235 F2d 369 (3d Cir.), inadequate consideration paid by the control group for stock violates 10b-5; *Shell* v. *Hensley,* 430 F2d 819, 827 (5th Cir.), the unfair use of controlling influence in the purchase or sale of securities spells out a fraud under 10b-5; *Rekant* v. *Desser,* 425 F2d 872, 882 (5th Cir.),

> "We conclude, therefore, that when officers and directors have defrauded a corporation by causing it to issue securities for grossly inadequate consideration to themselves or others in league with them or the one controlling them, the corporation has a federal cause of action under § 10(b) . . . . The essence of the transaction is not significantly different from fraudulent misrepresentation perpetrated by one individual on another";

Hooper v. *Mountain States Securities Corp.,* 282 F2d 195, 204 (5th Cir.) cert. den. 365 U.S. 814, "the essence of the" 10b-5 "fraud" was "a scheme to get Consolidated to issue . . . stock for worthless property." *Dasho* v. *Susquehanna Corp.,* 380 F2d 262, 270 (7th Cir.), the concurring majority sustained a complaint that a self-deal merger on unfair terms violates 10b-5; *Travis* v. *Anthes Imperial Ltd.,* 473 F2d 515, 527 (8th Cir.), Rule 10b-5 liability found even though "[t]he essence of the plaintiffs' complaint . . . is that the defendants violated § 10(b) and Rule 10b-5 by engaging in self-dealing. . . . Here, as in *Sup't of Insurance,* the defendants' self-dealing was a violation of a fiduciary obligation to minority shareholders . . ."; *Norris & Hirshberg, Inc.* v. *SEC,* 177 F2d 228 (U.S. Ct. App., D.C.), broker's purchases from, and immediate resales to, trusting customers, at higher prices, violates 10b-5 as fraud on customers. For further cases in accord, see VI Loss, *Securities Regulation,* Supp. to 2nd Ed. (1969), Sec. (vi) "Violation by non-verbal acts", pp. 3602-5.

Judge Hays stated with respect to the bargain sale of stock to the insider (215):

> What we have here then is a scheme by which the directors of Banff gave to the controlling stockholder (footnote omitted) and an affiliated corporation some millions of dollars worth of this corporation's property. *A plainer case of fraud would be hard to find.*

With respect to fraud through self-dealing, Judge Mansfield below stated the following:

> Our conclusion that where there has been self-dealing on the part of corporate insiders, proof of misrepresentation or non-disclosure is not a *sine qua non* to the establishment of 10b-5 liability is shared by other Circuits (150a).*

After citing and quoting from several cases, Judge Mansfield continued as follows:

> Defendants' efforts to reconcile these decisions by searching for some misrepresentation or non-disclosure ignores the court's plain language in each case and exalts form over substance. Such misrepresentations as may be found generally related to technical, trivial matters, having little or no relevance to the manipulative conduct giving rise to 10b-5 liability. Furthermore, in some of the cases the courts, in imposing § 10(b) liability were quite explicit in acknowledging the absence of misrepresentation or openly minimizing its import to the illegal conduct under challenge (152a).

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* The self-deal assumes (142a fn. 2) "for the purposes of this appeal . . . that the $150 per share offered by Kirby to the public shareholders is inadequate and that the correct buy-out price equals $772 per share, a sum derived by a pro-rata division of Kirby's appraised assets".

Here there was no economic reality to the merger. A paper corporation was created and immediately "merged" into Kirby Lumber as a mere device whereby Santa Fe, the majority holder, could squeeze out the Kirby minority at a small fraction of the true value of the minority's stock. As the Sixth Circuit U.S. Court of Appeals stated (*Marsh* v. *Armada Corp.*, 533 F2d 978) in explaining the 2nd Circuit's decision below:

> In *Green* . . . the merger was a sham transaction designed to expropriate the ownership interests of the minority shareholders (at page 986)—

at a small fraction of their value. The sham merger as a device to misappropriate the beneficiary's property was, plainly, a fraudulent and deceptive act, practice or scheme under the decisions of the Supreme Court and the other federal courts.

Santa Fe is itself a public corporation with outside stockholders; that was not changed by the merger of a dummy corporation into Kirby. All that happened was that a public entity squeezed out some members of the public and continued as a public going concern. Sante Fe, had it acted in good faith and without intent to overreach in the merger, could have offered the Kirby minority Santa Fe stock, tax-free (at a fair price) and thus a continuing interest in the enterprise—this is recommended by Professor Arthur H. Borden, *Going Private—Old Tort, New Tort or No Tort?* N.Y.U. Law Rev. Preprint (1974), at 1018-9. Here, the majority stockholder arranged the security transaction in such way as to be tax-free to itself but not to the minority, who, receiving cash, must report and pay a capital gains tax (75A). This disparate treatment favoring the fiduciary and discriminating against the cestui, without notice or compensation to or consent by the minority, was further fraudulent overreaching in violation of Rule 10b-5.

In *Lebold* v. *Inland Steel Co.*, 125 F2d 369, 136 F2d 876 (C.A.7) the insiders were held liable for having used dis-

solution proceedings, authorized by statute, for the purpose of eliminating minority stockholders from the profits to be made from the continuation of a going concern:

> Whether we stamp the happenings as dissolution or with some other name, equity looks to the essential character and result to determine whether there has been faithlessness and fraud upon the part of the fiduciary. However proper a plan may be legally, a majority stockholder can not, under its color, appropriate a business belonging to a corporation to the detriment of the minority stockholder. The so called dissolution was a mere device by means of which defendant appropriated for itself the transportation business of the Steamship Company to the detriment of plaintiffs. *That the source of this power is found in a statute, supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny.* Allied Chemical & Dye Corp. v. Steel & Tube Co. of America, 14 Del. 1, 120 A. 486. The books are full of instances of disapproval of such action.

A sham merger merely to eliminate a minority stockholder has been held to be a fraud against him at common law, *Bryan* v. *Brock & Blevins Co.,* 490 F2d 563, 570-571 (5th Cir.) cert. den., 419 U.S. 844, and in New York under the Martin Act, *Peop.* v. *Concord Fabrics, Inc.,* 50 AD2d 787 (1st Dept.) aff'g on op. below, 83 M 2d 120, involving the same merger invalidated under 10b-5 in *Marshel* v. *AFW Fabric Corp.,* 533 F2d 1277 (2nd Cir. 1976) vacated and remanded on another ground.

Moreover, the Fraud Here Also Included Misrepresentation and Non-Disclosure

In addition, a fiduciary implicitly represents that he will deal with his cestui fairly and in good faith. The fiduciary's willful and unconscionable misappropriation of its cestui's property in the forced purchase of the cestuis' Kirby

stock constituted an intentional misrepresentation within clause 2 of Rule 10b-5.*

Further, a material part of Santa Fe's scheme consisted in obtaining a fraudulent appraisal from Morgan and in persuading the minority stockholders that the $150 it had unilaterally fixed for each share was fair; that would deter challenges in the courts. To that end it paid Morgan $125,000 for Morgan's undervaluation of Kirby stock at $125, worth at least $772 per share, when Morgan knew that the pro rata market value of Kirby's physical assets was $772 per share (103a). By transmitting the dishonest appraisal to the stockholders, Santa Fe adopted, and made its own, a misstatement, as part of its fraudulent scheme.

Furthermore, as noted, the transaction was consummated without the prior knowledge or consent of the stockholders and accordingly there was material non-disclosure. The first time the stockholders heard of the merger and the taking of their stock was when Santa Fe informed them that their stock had already been taken by Santa Fe at $150 per share and if they didn't like it their only remedy was an appraisal proceeding. As Judge Mansfield held below (147a-148a):

> Defendants place heavy reliance upon *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972), as representing a departure from our steady trend toward an expansive view of the reach of the federal security laws. However, to the extent that *Popkin* is at all relevant to the short-form merger context, it impliedly supports the application of the *Schoenbaum-Drachman* rule to this case. In *Popkin,* unlike the present case, *prior* stockholder approval of the proposed merger

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* *U.S.* v. *George,* 477 F2d 508, 513 (7th Cir. 1973): "Here the fraud consisted in Yonan's holding himself out to be a loyal employee, acting in Zenith's best interests, but actually not giving his honest and faithful services, to Zenith's real detriment." (mail fraud, 18 USC § 1341).

was required. Full *advance* disclosure of the relevant facts regarding the merger exchange ratios to the minority stockholders was effective protection because it gave them the opportunity, as Judge Feinberg noted, to seek state court injunctive relief which was purportedly available under Delaware law. *Id.* at 720. Here, in contrast, disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out. Indeed, it is well recognized that the state post-merger appraisal procedure does not provide an alternative remedy comparable to federal relief. (original emphasis; footnotes omitted)*

The authorities are in accord with the decision below that only disclosure before the fact could in any event give the kind of investor protection contemplated by the anti-fraud provisions of the securities laws.** Thus, Harlan, J., explaining why purchase, cheap, by the control, on inside information, violated 10b-5 (*Speed* v. *Transamerica Corp.*,

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* Petitioners' reliance on *Popkin* v. *Bishop* (PBr. 11-12) is also misplaced because there there was no indication of any intention by the fiduciary to use the merger as a pretext to cheat the minority; the longterm merger it proposed, far from being a sham, was, in the words of the Court below, "as a practical matter compelling" (135a). Further, as Medina, C.J. stated, below (135a-136a):

> The plain implication [of *Popkin*] is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresentation or lack of disclosure to make out a 10b-5 case. . . . Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constitute the fraud, and not whether or not the majority determines to lay bare their real motives.

** Though a non-verbal fraud may not be neutralized even by advance disclosure, *Marshel* v. *AFW Fabric Corp., supra,* 533 F2d, at 1282.

235 F2d 369) stated:

> Had shareholders been aware of the concealment, they would undoubtedly have refused to sell. *Capital Gains Bureau, supra,* 375 U.S. 180, at 205 (dissg. op.).

The disclosure must be in advance so that the investor can protect himself by preventing the sale on the terms given, *Affiliated Ute Citizens* v. *U.S.*, 406 U.S. 128, 153. Telling him after the sale is shutting the barn door after stealing the horse. So in *Bailey* v. *Meister Brau, Inc.*, 535 F2d 982 (7th Cir. 1976), the Court held that it was a violation of 10b-5 for "the controlling stockholder [to cause] the corporation to engage in a securities transaction in which the stockholder has a conflict of interest [and which] was unfair to the corporation," because he had not disclosed information "which reflects on the fairness of the transaction" to "the only stockholder whose interests lay with the corporate entity":

> He was thus deprived of any opportunity to protect the interests of the corporation and of himself as minority shareholder (p. 993).*

Therefore, plaintiffs also established a violation of Rule 10b-5, Clause 2, misrepresentation and nondisclosure.**

Santa Fe implicitly acknowledges that *Schoenbaum* was correctly decided and states (p. 15, fn.) *there* "the defend-

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* Cf. *Nader* v. *Allegheny Airlines,* —— U.S. ——, 48 L. Ed. 2d 643, a common law action of fraud and deceit was maintainable by a passenger for nondisclosure by an airline of its overbooking practice which resulted in his being bumped, even though he was subsequently informed that by reason of the overbooking he could obtain compensation for the bumping.

** Nondisclosure, here, was also a part of the "device, scheme or artifice to defraud" under clause 1 and part of the "act, practice or course of business which operates . . . as a fraud or deceit upon any person" under clause 3 of 10b-5. See *Capital Gains Research, supra,* 375 U.S., at 198-199.

ants had caused the corporation to sell stock at an unreasonably low price, without disclosing that they had inside information of a major oil discovery which would greatly increase the value of the shares.'' But *here,* on July 31, 1974, ''the defendants had caused [Kirby] to [buy] stock at an unreasonably low price, without disclosing that they had inside information of [an appraisal] . . . which would greatly increase the value of the shares" to $772 per share. So *Schoenbaum* squarely applies.

Santa Fe's reference (p. 15, fn.) to *Voege* v. *American Sumatra Tobacco Corp.,* 241 F.Supp. 369 (D. Del. 1965), states (p. 15, fn.):

> the defendants had acquired their 90% position through a tender offer, in connection with which they concealed the fact that they planned a partial liquidation of assets which would result in a higher yield per share than the total price being offered (241 F.Supp. at page 373).

Here, defendants acquired 100% of Kirby through a short form merger, ''in connection with which they concealed the fact [on July 31, 1974] that they [in effect, carried out a] liquidation of assets which would result in a higher yield per share" than the price being paid to the minority. So *Voege* squarely applies. Defendants' confession of the fraud, on August 1, 1974 the day after its consummation, does not immunize them from liability.

The Decision Below Against Santa Fe Gives Proper Effect To "The Federal Regulatory Scheme Governing Transactions In Securities".

In *Ernst & Ernst, supra,* the Supreme Court gave decisive effect to the express language of Section 10(b) and Rule 10b-5, as suported by the purpose and legislative history of the 1934 Act. Since the manifest language and purpose of Section 10(b) and Rule 10b-5 is to cover all fraudulent misconduct in the purchase or sale of securities,

that should be the end of the inquiry. Section 10-b is a mandate of Congress and Rule 10b-5 was validly promulgated thereunder. The federal courts will therefore enforce it ''flexibly, not technically and restrictively." *Supt. of Insur., supra,* 404 U.S., at 12. Under Article VI clause 2 of the U.S. Constitution, Section 10(b) and Rule 10b-5 are the supreme law of the land.* Moreover, the abuse of a state form provides no defense for a violation of the substance sought to be protected by the federal enactment.

Delaware, in allowing a short form merger, did not purport to license fraud. In *David J. Greene & Co.* v. *Schenley Industries, Inc.,* 281 A2d 30, 35 (Del. Ch. 1971), the Court stated as follows:

> In short, I am of the opinion that the rights of plaintiffs and of other minority stockholders of Schenley, viewed in the light of Glen Alden's holding of approximately 84% of the common stock of Schenley, are no greater under the present Delaware merger statute here involved (8 Del.C. § 251) than under the so-called short-merger statute (8 Del.C. 253). Thus, if plaintiffs and others are not satisfied with the value placed on their shares by Glen Alden, and no *fraud or blatant overreaching* is demonstrated, their recourse is to an appraisal, Stauffer v. Standard Brand, supra.**

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* As the Court of Appeals stated below (124a):

. . . the states have no power to preempt Congress in the creation of substantive rights and remedies arising from purchases and sales of securities in interstate commerce . . .

** As for the standard of ''fraud or blatant overreaching'', it is the one referred to in *Popkin* for Delaware law; thus, quoting *Greene* further (32):

> Glen Alden concedes that its control of the affairs of Schenley, including the naming of its directors and officers, is such as to call into play the rule applicable in all instances of corporate self-dealing, namely that when officers and directors stand on both sides of a transaction complained of "* * * they bear the burden of establishing its entire fairness, and it

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The mere fact that Santa Fe followed the form of a merger authorized by the state does not acquit it of the charge of fraudulent abuse. As the Supreme Court held in *Supt. of Insurance, supra,* in finding a violation of Rule 10b-5, "practices legitimate for some purpose may be turned to illegitimate and fraudulent means", 404 U.S., at 12. In the classic case of *Pepper* v. *Litton,* 308 U.S. 295, 306, this Court held:

> A director is a fiduciary . . . So is a dominant or controlling stockholder or group of stockholders . . . *Their powers are powers in trust.*

The Delaware short-form merger gave Santa Fe, with respect to Kirby and its minority stockholders, "a power in trust", not a license to abuse it and them. That the defendants followed meticulously the wording of the short-form merger provision is of course no evidence of lack of fraud. A long time ago the Supreme Court had occasion to point out that

> It is insisted that the proceedings were all conducted according to the forms of law. Very likely. Some of the most atrocious frauds are committed in that way. Indeed, the greater the fraud intended, the more particular the parties to it often are to proceed according to the strictest forms of law. *Graffam* v. *Burgess,* 117 U.S. 180, 186.

Thus in the leading case of *Lebold* v. *Inland Steel Co., supra,* the insiders were held liable for fiduciary fraud even

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> (the transaction) must pass the test of careful scrutiny by the courts".

In *Stauffer* v. *Standard Brands, Inc.,* 187 A2d 78 (Del.Sup. Ct. 1962), cited by the petitioners (PBr., *e.g.,* at p. 20), there was no showing of an intentional abuse of a fiduciary relationship; that is, a deliberate use of a short form merger for the substantial purpose of cheating the minority; moreover, prior notice of the merger was given to the stockholders; and the merger was warranted by legitimate business purposes.

though they had meticulously followed the letter of state-authorized dissolution proceedings; their purpose was eliminating minority stockholders without adequate compensation from the profits to be made from the continuation of a going concern. *Lebold* required the fiduciary to pay *more* than the value of the tangible assets; in our case the fiduciary has determined to pay even *less* than the fair value of the tangible assets.*

Petitioners say (PBr. 18) that under the Delaware procedure appraisal is the stockholders' exclusive remedy. While this assertion is not indubitable,** we believe that it is immaterial because the provision of any given remedy does not negate the fact that it is a fraud and particularly because what remedy is afforded by the state has no bearing on whether the transaction contravenes Rule 10b-5.

* The Court of Appeals stated (125 F2d, at 375):

> "Henry Ford could not rightfully say to one of the stockholders who invested in the Ford automobile company in its beginning and whose investment had multiplied thousands of times in value, that in view of the handsome returns he had upon the investment, he must deliver the stock to Mr. Ford upon receipt of his pro rata share of the value of the physical assets of the Ford Company or Mr. Ford would dissolve the company and bid in the assets and deprive him of any such returns."

** See *David J. Greene & Co., supra; Popkin* v. *Bishop,* 464 F2d 714, 720 (2nd Cir. 1972):

> Indeed, under the applicable Delaware law, the "entire fairness" of the merger would have to pass "the test of careful scrutiny by the courts" *Sterling* v. *Mayflower Hotel Corp.,* 33 Del. Ch. 293, 93 A2d 107, 110 (1952).

Bryan v. *Brock & Blevins Co.,* 490 F2d 563, 570-571 (5th Cir.) *cert. den.* 419 U.S. 844 (Georgia law) and *Peop.* v. *Concord Fabrics, Inc.,* 50 AD2d 787 (1st Dept.) aff'g on op. below, 83 M2d 120; *Berkowitz* v. *Power/Mate Corp.,* 137 N.J. Super. 36, 342 A2d 566 (Sup. Ct., Ch. Div. 1975) (unfair price); *Jutkowitz* v. *Bourns,* No. CA 000268 (Cal. Super. Ct., L.A. Co., 1975) (no sufficient corporate purpose), enjoined mergers under state law for fiduciary fraud. Of course, if the state does not provide equitable relief, that is all the more reason why the plenary relief to enforce Rule 10b-5 should be allowed.

The Supreme Court so held in *Supt. of Insurance, supra,* 404 U.S., at 12:

> Since there was a "sale" of a security and since fraud was used "in connection with it" there is redress under Section 10(b), whatever might be available as a remedy under state law.

The inadequacies in the appraisal remedy are set forth in the concurring opinion below of Mansfield, C.J. (148a-150a, fn. 4).*

Petitioners' suggestion (PBr. 19) that the operative terms in Section 10(b) and Rule 10b-5 can have only the meaning allowed by Delaware law is untenable. As this Court stated in *Ernst & Ernst, supra,* 425 U.S., at 206:

> The 1933 and 1934 Acts constitute interrelated components of the *federal regulatory scheme governing transactions in securities.*

There would be no "federal regulatory scheme" if Section 10(b) and Rule 10b-5 were fragmented into 50 state laws.**

* Indeed, at least with respect to fiduciary fraud, Delaware's short form merger statute, with appraisal as the exclusive remedy, would appear to be so arbitrary as to deny due process. *North Georgia Finishing Inc.* v. *Di-Chem, Inc.,* 419 U.S. 601, and cases cited there. In declaring unconstitutional the statute in *Di-Chem* which provided for impounding a bank deposit *pendente lite,* the Supreme Court held that even a temporary deprivation of "use or possession" "is within the purview of the Due Process Clause" (at 606) and pointed to the fatal vice in the statute as follows (607):

> There is no provision for an early hearing at which the creditor would be required to demonstrate at least probable cause for the garnishment.

A like defect appears in the merger-appraisal statutory procedure, as construed by the defendants.

** See Circuit Judge Friendly, "In Praise of Erie—And Of The New Federal Common Law", *passim* and particularly p. 33: In the application of Rule 10b-5, the "interstitial supplementation is a matter of federal law"; and "the emphasis was on higher standards of conduct".

As a matter of national policy Congress has legislated against fraud in securities transactions and indeed has given the federal courts exclusive jurisdiction over the 1934 Act (15 U.S.C. § 78aa). The federal courts will therefore construe the terms of Section 10(b) and Rule 10b-5 in accordance with their plain meaning and history (*Ernst & Ernst, supra*), at 197 and 214, n.33 and in accordance with the congressional purpose. *Id.* at 194-5, 198, 206. Thus *SEC* v. *Nat'l Securities, Inc.,* 393 U.S. 453 (1969) held that even though a State had approved a merger of two corporations with appraisal rights as the remedy for the minority stock, "The paramount federal interest in protecting shareholders" (463) dictated that the federal court could set aside the merger under Rule 10b-5 (463-4). Petitioners cite *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (PBr. 20) but of course that case involved the law to be applied by a federal court under its diversity jurisdiction, not federal question jurisdiction. *Cort* v. *Ash,* 422 U.S. 66 (cited PBr. 20) disallowed a federal civil damage remedy under the statute there in question, but "the existence of a private cause of action for violations of the statute [§ 10(b)] and the Rule [10b-5] is now well established." *Ernst* v. *Ernst, supra,* at 196.*

Petitioners speak (PBr. 20) of "preemption of state corporate law" but nothing in the decision below suggests preemption of Delaware law. As Mansfield, C.J. stated in his concurring Opinion (152a) non-fraudulent short form mergers are not forbidden by Rule 10b-5. Section 10(b) and Rule 10b-5 are not concerned with short form mergers,

* In *Cort, supra,* 422 U.S., 66, 85 the Court expressly pointed to the distinction between the case before it and the federal securities laws, stating:

> In *Borak,* the statute involved [Section 14(a) of the 1934 Act] was clearly an intrusion of federal law into the internal affairs of corporations; to the extent that state law differed or impeded suit, the congressional intent could be compromised in state-created causes of action.

long form mergers or any other corporate procedures—these are all matters of state law and remain so under the decision below. Rather, Section 10(b) and Rule 10b-5 embody "the federal interest at stake" in preventing "the kinds of fraud and manipulation in securities dealings to which a corporation [including its minority] is specially susceptible" by means of instruments of interstate commerce, regardless of the form under State law that the transaction takes.* As this Court stated in *United Housing Found., supra,* in noting the "primary purpose" of the 1933 and 1934 Acts "to eliminate serious abuses in a largely unregulated securities market" and the federally felt "need for regulation to prevent fraud and to protect the interest of investors"—

> Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying "a transaction and not on the name appended thereto" (421 U.S., at 849).

Petitioners' suggestion (PBr. 20), that Delaware's interest in short form mergers by private corporations is comparable to its interest in the wages it may be required to pay its own employees in the discharge of its sovereign responsibilities, is so far-fetched as to be untenable on its face. The commerce power of Congress over securities fraud is beyond serious question and is not in issue in this case.

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* Note, *supra,* 86 Harv. L. Rev., at 1046.

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals with respect to petitioners should be affirmed.

Respectfully submitted,

SIDNEY BENDER
Attorney for Respondents
405 Lexington Avenue
New York, New York 10017
Tel. No. (212) 986-4080

Of Counsel:

AARON LEWITTES

IN THE

Supreme Court of the United States

OCTOBER TERM 1976

No. 75-1753

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC. and KIRBY LUMBER CORPORATION,

Petitioners,

against

S. WILLIAM GREEN, ET AL.,

Respondents.

REPLY BRIEF ON BEHALF OF PETITIONERS

WILLIAM R. GLENDON
Attorney for Petitioners
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

Of Counsel

ROGERS & WELLS
ROBERT D. LARSEN
GUY C. QUINLAN
GENE M. BAUER
200 Park Avenue
New York, New York 10017
Tel. No. (212) 972-7000

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REPLY BRIEF ON BEHALF OF PETITIONERS

Faced with a record showing full disclosure, and a complete absence of deception, plaintiffs have carefully avoided dealing with the specific language of the statute involved in this action, which expressly refers to "manipulative or deceptive'' devices. Instead, they have collected broad definitions of ''fraud'' from a variety of other sources, and then sought to read these definitions back into Section 10(b) of the Securities Exchange Act of 1934. Despite the rhetorical claims of "fraud," there is no element of manipulation or deception in the present action. That being true, the amended complaint fails to state a claim under Section 10(b) and Rule 10b-5.

1. Plaintiffs argue (Resp. Br. p. 11, *et seq.*)* that the second subsection of Rule 10b-5 covers the entire field of misrepresentation and non-disclosure, and that therefore the other subsections must apply to situations where deception is altogether absent. This argument, however, does not survive a fair reading of the Rule. Subdivision (b) of Rule 10b-5 applies, by its terms, only to untrue statements of fact, and to the omission of facts which are "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Thus, subdivision (b) covers only affirmative misrepresentations and half-truths. Deception, however, also consists of the complete suppression of facts, where there is a duty to speak; these situations of complete concealment and non-disclosure are covered by the first and third subsections (as is market manipulation). As was pointed out by the court in *Connelly* v. *Balkwill*, 174 F.Supp. 49, 59 (N.D. Ohio 1959), *aff'd on the opinion below*, 279 F.2d 685 (6th Cir. 1960):

> "Section (b) [of Rule 10b-5] requires that when a person speaks he must speak the whole truth. But that section does not in terms require a person to speak at all except when necessary to dispel the misleading implications of an antecedent partial disclosure. Section (a) of the rule forbids any scheme or artifice to defraud. Section (c) prohibits any act, practice or course of business which operates or would operate as a fraud or deceit. It is undoubtedly true, therefore, that when read as a whole, Rule X 10b-5 imposes the duty to speak and to make a full disclosure of material facts in those circumstances where silence would constitute fraud."

* Citation to "(Resp. Br. p.)" are to respondents' brief in this Court.

See, also, List v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965), *cert. denied*, 382 U.S. 811; *Joseph* v. *Farnsworth Radio & Television Corp.*, 99 F.Supp. 701, 706 (S.D.N.Y. 1951), *aff'd per curiam*, 198 F.2d 883 (2d Cir. 1952); *Trussell* v. *United Underwriters, Ltd.*, 228 F.Supp. 757, 762 (D. Colo. 1964).

This distinction is illustrated by *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, incorrectly cited by plaintiffs (Resp. Br. p. 16) as suggesting that the first and third subsections do not require deception. Immediately following the language quoted by plaintiffs, the Court in *Affiliated Ute* went on to state (406 U.S. at page 153):

> "These defendants' activities, outlined above, disclose, within the very language of one or the other of those subparagraphs, a 'course of business' [subsection (c)] or a 'device, scheme, or artifice' [subsection (a)] that operated as a fraud upon the Indian sellers. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*. This is so because the defendants devised a plan and induced the mixed-blood holders of UDC stock to dispose of their shares *without disclosing to them material facts* that reasonably could have been expected to influence their decisions to sell." [Emphasis supplied]

Thus there is no foundation for plaintiffs' effort to extend the Rule beyond the terms of the statute. The scope of the Rule is not, and obviously cannot be, any broader than the manipulation and deception proscribed by the statute.

2. Plaintiffs make a similar argument (Resp. Br. p. 10) as to the three subdivisions of Section 17(a) of the 1933 Act, arguing that Subsection (2) covers all misrepresentations or omissions, and that therefore Subsections (1) and (3) must be intended to cover "frauds or deceptions that might not come under the category of misrepresentations or omissions." From this plaintiffs go on to argue that

their reading of Rule 10b-5 is supported by the "language and purpose" of Section 17(a).

Apart from the curious effort to interpret a rule under one statute by reference to a different statute,* plaintiffs are simply wrong. Section 17(a)(2), like Subsection (b) of Rule 10b-5, refers only to misstatements of fact, and to omission of those facts which are "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Thus Section 17(a)(2) is "specifically aimed at half-truths, as distinct from complete omissions." *Trussell* v. *United Underwriters, Ltd., supra,* 228 F. Supp. at page 762. Again, it is 17(a)(1) and 17(a)(3) which cover instances of complete concealment and non-disclosure by a seller or offerer of securities.

Plaintiffs' interpretation of the "language and purpose" in Section 17(a) is, further, contradicted by the legislative history of the 1933 Act. The Securities Act was intended to protect investors against false and deceptive practices, by requiring full disclosure of material information. *See, e.g., Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 195, 198; III Loss, Securities Regulation, page 1542. Thus, the Senate Report on the Act began with the following statement (Senate Report No. 47, 73d Cong., 1st Sess., Committee on Banking and Currency, April 17, 1933 at 1, 2):

> "The purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation."
>
> * * *

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* As this Court pointed out in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 200, "the standard of liability created by a particular section of the [1933 and 1934] Acts must therefore rest primarily on the language of that section."

> "The necessity for the bill arises out of the fact that billions of dollars have been invested in practically worthless securities, both foreign and domestic, including those of foreign governments, by the American public through incomplete, careless, or false representations."

3. Plaintiffs further seek to eliminate manipulation and deception as necessary elements of the statute by arguing (Resp. Br. p. 11) that the "legislative history" of Section 10(b) shows that it was intended to be a "catch-all." Undoubtedly, Section 10(b) was intended as a catch-all for all forms of manipulation and deception; but in that function, the statutory elements of manipulation or deception must still be present, and nothing in the legislative history dispenses with this requirement. However, it is doubtful whether any reference to legislative history is necessary or appropriate in view of the clarity of the statutory language. "Not wishing 'to give point to the quip that only when legislative history is doubtful do you go to the statute,' we begin by looking to the text itself." *United States* v. *Bass,* 404 U.S. 336, 339 (1971) [footnote omitted]. Since Section 10(b) "speaks so specifically in terms of manipulation and deception," *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at page 214, its terms cannot be circumvented as plaintiffs seek to do here.

In fact, such "legislative history" as exists on this point actually negates plaintiffs' interpretation. The Senate Report on the 1934 Act specifically tied the express liability sections of the Act to manipulation and deception:

> "[T]he bill provides that any person who unlawfully manipulates the price of a security, or who induces transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report of a corporation, shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement."

S. Rep. No. 792, 73d Cong. 2d Sess., 1934, pages 12-13. As the Court stated in *Hochfelder, supra,* "the catchall provision of § 10(b) should be interpreted no more broadly" than the sections which expressly impose liability (425 U.S. at page 206). And as the Court noted in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736:

> "It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

Plaintiffs' device of stretching Section 10(b), beyond the language of the statute and beyond the express liability provisions of the 1934 Act, is equally "anomalous," finds no support in the legislative history, and should be rejected.

4. Plaintiffs are equally inaccurate in arguing that the prior case law, under Section 10(b) and Rule 10b-5, supports the result below. Thus plaintiffs repeatedly cite (Resp. Br. pp. 8, 9, 16, 31-34) *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, for the proposition that Rule 10b-5 reaches any "breach of fiduciary duty," and that deception is unnecessary. In fact, however, the Court expressly "read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securiites" (404 U.S. at page 12), and stated (404 U.S. at pages 12-13): "The crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor." The Court held (404 U.S. at page 9):

> "There certainly was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated as 'a fraud or deceit' on Manhattan, the seller of the Government bonds. To be sure, the full market price was paid for those bonds; but the seller was duped into believing that it, the seller, would receive the proceeds." [footnote omitted]

Deceptive bookkeeping entries were also used in *Bankers Life,* so that Manhattan's books "reflected only the sale of its Government bonds and the purchase of the certificate of deposit and did not show that its assets had been used by Begole to pay for his purchase of Manhattan's shares or that the certificate of deposit had been assigned to New England and then pledged to Belgian-American Banking" (404 U.S. at pages 8-9). The lower court cases cited in plaintiffs' footnote (Resp. Br. pp. 22-23) are equally inapposite.*

5. Throughout their brief, plaintiffs ignore the specific language of Section 10(b), preferring instead to discuss generalized definitions of "fraud" from such sources as treatises on equity jurisprudence (Resp. Br. pp. 19-20), cases under the bankruptcy laws (*Pepper* v. *Litton,* 308 U.S. 295, cited Resp. Br. pp. 9, 32), and a curious collection

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* Thus, *e.g., Schlick* v. *Penn-Dixie Cement Corp.,* 507 F.2d 374 (2d Cir. 1974), *cert. denied,* 421 U.S. 976, involved allegations of deceptive accounting practices, to reduce the apparent income of one company and increase that of another, as well as deliberate market manipulations (see pages 10-11, *infra*). *Pappas* v. *Moss,* 393 F.2d 865 (3d Cir. 1968) (cited Resp. Br. p. 22 n.), was a derivative suit against directors who had purchased stock of their corporation on favorable terms; shareholder ratification of the purchase had been obtained through materials which contained "at least two material misrepresentations of fact" (393 F.2d at page 869). *Shell* v. *Hensley,* 430 F.2d 819 (5th Cir. 1970) (cited Resp. Br. p. 23) was a derivative suit against officers who had conspired to devote corporate funds to their personal use; among the specific deceptions alleged were non-disclosures as to the value of securities and land sold to the corporation, and a bogus employment contract intended to conceal improper payments to one of the defendants (430 F.2d at page 825). The holding in *Rekant* v. *Desser,* 425 F.2d 872 (5th Cir. 1970) was expressly based on findings that the defendants had made "affirmative misrepresentations" in reports to shareholders, and had "violated the directors' duty to disclose fully the material facts. . . ." (425 F.2d at page 882).

of common law fraud decisions.* As in the court below, plaintiffs also rely heavily on dictum from *S.E.C.* v. ***Capital Gains Research Bureau, Inc.***, 375 U.S. 180 (Resp. Br. pp. 16-18), ignoring the fact that *Capital Gains* arose under the Investment Advisers Act of 1940, and in any event did involve deception through non-disclosure (see Petitioners' principal brief pages 14-15).

The essential fallacy of plaintiffs' position is the assumption that every alleged wrong must have a federal, as well as a state, remedy; plaintiffs' argument really is that any complaint which could state a cause of action at common law, for constructive "fraud," fiduciary breach, or "overreaching" must also state a claim under the specific provisions of Section 10(b). As the court noted in *Marsh* v. *Armada Corp.*, 533 F.2d 978, 979 (6th Cir. 1976), petition for certiorari filed No. 76-5:

> "This action is one of an increasing number of lawsuits in which minority shareholders, dissatisfied with the merger terms under which their stock is to be converted into cash or stock of the controlling corporation, seek a federal remedy by alleging violations of Section 10(b) of the Securities Act of 1934 (hereinafter Exchange Act) and Rule 10b-5 promulgated thereunder.
>
> "A common feature in this type of lawsuit is what is in reality a state law claim for unfairness or breach of fiduciary duty on the part of corporate officers and directors."
>
> * * *

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* *E.g.*, ***Grin*** v. ***Shine***, 187 U.S. 181 (1902) (cited Resp. Br. p. 19) involved a habeas corpus proceeding, brought by a person facing extradition to Czarist Russia for embezzling 25,000 rubles. ***Graffam*** v. ***Burgess***, 117 U.S. 180 (1886), (cited Resp. Br. p. 20), involved a real estate foreclosure. ***Moore*** v. ***Crawford***, 130 U.S. 122 (1889) (cited Resp. Br. p. 17) was an action to compel the execution of a deed.

> "Thus in dealing with the issues raised here we are not faced with the question whether the defendants' alleged wrongs call for a remedy, but only whether plaintiffs should have access to the federal courts as well as the state courts to seek the remedy."

Under our federal system, however, the redress of many categories of grievances is still entrusted to the law of the states, in the absence of a clear federal preemption. ***Lehman Brothers*** v. ***Schein***, 416 U.S. 386, 389. As discussed below, and at pages 19-27 of our principal brief, no such congressional preemption is involved here.

6. Plaintiffs also argue (Resp. Br. pp. 5, 8) that the short form merger herein violated Rule 10b-5 because it lacked a valid "corporate purpose." However, the entire issue of "corporate purpose," which was raised *sua sponte* by the panel below,* is irrelevant under the statute which plaintiffs purport to invoke: the presence or absence of a corporate purpose has no bearing whatever on the issue of deception or manipulation.

The issue of "corporate purpose" is equally irrelevant to the actual grievance of plaintiffs in this case. Assuming that the present merger had been required by the clearest possible "corporate purpose," plaintiffs would still have had precisely the same grievance they have now: a dis-

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* As noted in defendants' principal brief (page 16), plaintiffs had abandoned the corporate purpose argument in the Court of Appeals. Accordingly, the issue was not briefed or argued by either side. The majority of the panel below, however, revived the issue on its own motion, and proceeded on the assumption, contrary to the record (A 19a-20a), that Kirby's funds had been used in the short form merger (533 F.2d at pages 1285, 1280, 1290). Proceeding from this erroneous premise, the panel took over almost verbatim the holding in ***Marshel*** v. ***AFW Fabric Corp.***, 533 F.2d 1277, 1282 (2d Cir. 1976), ***rehearing denied***, 533 F.2d 1309 (2d Cir. 1976), ***vacated and remanded***, 97 S. Ct. 228, where corporate funds had in fact been used to buy the minority shares.

satisfaction with the price tendered for their stock. That, and that alone, is the substance of plaintiffs' claim (533 F.2d at page 1288). The present action is before this Court, not because of the presence or absence of a "corporate purpose," but simply because plaintiffs preferred to bring an appraisal action in the federal, rather than the state court.

Further, neither plaintiffs nor the panel below have ever articulated any standards by which the validity of a "corporate purpose" could be ascertained. In thus rewriting the Delaware statute, which exists for the sole purpose of facilitating short form mergers, the majority implicitly held that none of the corporate advantages which Judge Moore listed as inherent in such a merger (533 F.2d at page 1308) would suffice to meet this test. However, the majority made no intelligible statement as to what more is required, or how the sufficiency of a corporate purpose can be measured. As Judge Moore stated (533 F.2d at page 1309):

> " I cannot believe that the majority has chosen to exceed the bounds of its jurisdiction under federal law in order to espouse so frail a concept, and I am more convinced than ever of the wisdom which the Supreme Court showed in compelling the federal judiciary to refrain from the business of rewriting state law by judicial fiat."

7. Plaintiffs also attempt, in passing, to assert (Resp. Br. pp. 13-14) that the events in this action fall within the definition of "manipulation," and thus come within the scope of Section 10(b). This position is equally untenable. Manipulation in the securities context is "virtually a term of art," for conduct intended to mislead investors by creating a deceptive appearance of market activity, such as "wash" sales and "matched" orders. *See Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at pages 199, 205; III Loss, Securities Regulation, p. 1529 *et seq.* The statutory intent

appears clearly from the House Report accompanying the 1934 Act, which stated that "the accentuation of temporary fluctuations and the deliberate introduction of a m[illegible] psychology into the speculative markets by the fanfare of organized manipulation menace the true functioning of the exchanges." H. R. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 11.

The meaning of "manipulation" in the 1934 Act is further illustrated by Section 9 of the statute, "Prohibition Against Manipulation of Security Prices." All of the specific practices enumerated in Section 9—fictitious sales, matched orders, dissemination of misleading projections, stabilization, and others—are potential devices for creating a false appearance of market activity.* In terms, "non-disclosure of a manipulation is usually, if not invariably, essential to its success." III Loss, Securities Regulation, page 1565. No allegation of manipulation, within the meaning of the 1934 Act, is involved in this action.

8. Plaintiffs also argue in the alternative (Resp. Br. pp. 26-30) that there was "misrepresentation and non-disclosure," because the admittedly full disclosure in the information statement was sent the day after the short form merger, rather than before. In this connection plaintiffs rely upon the statement in Judge Mansfield's concurring opinion (533 F.2d at page 1297) that the disclosure was made "too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out."

Despite Judge Mansfield's suggestion, there is no such thing under Delaware law as an "unwarranted squeeze-out" in a short form merger. This is so "because the very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise. Thereafter the former stock-

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* The text of Section 9 is reprinted as an Appendix to this reply brief.

holder has only a monetary claim." *Stauffer* v. *Standard Brands Incorporated,* 187 A.2d 78, 80 (Del. Sup. Ct. 1962). No other "corporate purpose" is required for a short form merger. *Singer* v. *The Magnavox Company,* A.2d (Del. Ch. Oct. 26, 1976); *Bruce* v. *E. L. Bruce Company,* 174 A.2d 29, 30 (Del. Ch. 1961). The only aspect of a short form merger which could be "unwarranted," under Delaware law, would be an inadequate price, which any dissatisfied stockholder is free to reject, in favor of a judicial appraisal proceeding in the Delaware Court of Chancery. Thus, any application to the Delaware state courts for a preliminary injunction would necessarily be denied, on the ground that the minority stockholders had an adequate remedy at law. There would be no remedy under state law for the stockholders to "invoke" other than appraisal.

Thus, pre-merger notice, under the Delaware statute, would serve no useful function whatever. In arguing that the absence of prior notice violates Rule 10b-5, plaintiffs are in the unusual position of arguing that it was a deceptive device to follow the terms of the Delaware statute. This argument is untenable.

Under such circumstances, the relevant question under the federal securities laws is whether full and fair disclosure has been made, in time and in a manner for the minority stockholders to make an informed decision. As the Second Circuit earlier observed, in *Popkin* v. *Bishop,* 464 F.2d 714, 720 n. 16 (1972):

> ''Where the right to appraisal and payment for shares is the exclusive shareholder remedy under state law, the federal disclosure provisions are still not 'nugatory.' They will help ensure that shareholders have the information necessary for an intelligent exercise of their appraisal rights.''

9. Plaintiffs seek to dismiss the serious problem of federalism, raised by the decision below, with the truism (Resp. Br. p. 36) that ''the commerce power of Congress over securities fraud is beyond serious question and is not an issue in this case.'' That observation is irrelevant here: nothing in Section 10(b) indicates a Congressional intent to treat short form mergers, which are valid under state statutes, as constituting ''securities fraud.'' Even strong advocates ~~of federal~~ corporate legislation have expressed concern at the pressure, in recent Rule 10b-5 litigation, "to take new ground that is really beyond the ground of disclosure that the 1933-34 system was designed to allocate to the Federal Government.''[*] This, however, is precisely what the court below has done, without any statutory support.

Nor is the problem avoided by asserting (Resp. Br. p. 35) that Delaware law will still be permitted to operate as to ''non-fraudulent'' short form mergers. To be ''non-fraudulent'' under the decision below, a merger must meet a requirement of independent ''corporate purpose,'' when the Delaware courts have emphatically repudiated any such requirement. *See, e.g., Stauffer* v. *Standard Brands Incorporated, supra,* 187 A.2d at page 80; *Bruce* v. *E. L. Bruce Company, supra,* 174 A.2d at page 30; *Singer* v. *The Magnavox Company,* A.2d (Del. Ch. Oct. 26, 1976). It is equally specious to dismiss the conflict with state law by asserting (Resp. Br. p. 32) that a fraud may be committed while following the forms of a statute: in this case the *raison d'être* of the state statute is to permit the very act which is here attacked as ''fraud.'' As was recognized by the concurring opinion below, ''state law has authorized the [short form merger] device to be used for the purpose of squeezing out the public shareholders

* Testimony of Professor Detlev Vagts, Senate Serial No. 94-95, Committee on Commerce, 94th Cong., 2d Sess., 1976, p. 333.

without giving them prior notice or an opportunity to obtain injunctive relief. . . ." (533 F.2d at page 1296, quoted by plaintiffs at Resp. Br. p. 22).*

Plaintiffs are in effect urging that wide areas of state corporation law should be displaced or rewritten by federal judicial action. The desirability of such federal preemption should, however, be decided by the Congress and not by the courts. A federal corporation statute would at least avoid the wide-reaching uncertainty which the decision below would inject into areas now covered by state law: the vague and open-ended scope of the panel's decision in this case would inevitably cause a massive increase in the volume of litigation, the bulk of which, based on past experience, would be brought in the federal rather than the state courts. See Sherrard, *Fiduciaries and Fairness Under Rule 10b-5,* 29 Vanderbilt L.Rev. 1385, 1417-18 (1977). Further, the resulting confusion would undermine the certainty which has been a primary objective of state corporation law, and a primary attraction of the Delaware statute.**

Similar considerations have led even vigorous advocates of comprehensive federal standards to recognize that "it seems anomalous to jig-saw every kind of corporate dispute into the federal courts through the securities acts as

* Equally insufficient are plaintiffs' repeated assertions that the merger involved "self-dealing" (Resp. Br. pp. 24, 25). Every merger of a parent and its subsidiary necessarily involves "self-dealing," and that alone is not sufficient to make it fraudulent. Delaware law is clear that "the merger is an act of independent legal significance and the mere fact that those who initiate it will receive some benefit does not make it fraudulent." *MacCrone* v. *American Capital Corporation,* 51 F. Supp. 462, 469 (D. Del. 1943) [footnote omitted].

** *See, e.g.,* testimony of former Commissioner A. A. Sommer, Jr. of the S.E.C., Senate Serial No. 94-95, Committee on Commerce, 94th Cong., 2d Sess., 1976, p. 58.

they are presently written." Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 Yale L.J. 663, 700 (1974). We submit that the court below erred in seeking to "jig-saw" short form mergers, lawful under state statutes, into the disclosure provisions of Section 10(b) and Rule 10b-5.

Conclusion

For the reasons set forth above, and in petitioners' principal brief, the decision below, with respect to petitioners, should be reversed.

Respectfully submitted,

WILLIAM R. GLENDON
Attorney for Petitioners
200 Park Avenue
New York, New York 10017
(212) 972-7000

Of Counsel:

ROGERS & WELLS

ROBERT D. LARSEN
GUY C. QUINLAN
GENE M. BAUER

Appendix—Statutes

SECTION 9 OF THE SECURITIES EXCHANGE ACT OF 1934

§ 78i. Manipulation of security prices

(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

(1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

(3) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the

security, to induce the purchase or sale of any security registered on a national securities exchange by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the prices of such security.

(4) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

(5) For a consideration, received directly or indirectly from a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to induce the purchase or sale of any security registered on a national securities exchange by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(6) To effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) It shall be unlawful for any person to effect, by use of any facility of a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors—

(1) any transaction in connection with any security whereby any party to such transaction acquires any put, call, straddle, or other option or privilege of buying the security from or selling the security to another without being bound to do so; or

(2) any transaction in connection with any security with relation to which he has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege; or

(3) any transaction in any security for the account of any person who he has reason to believe has, and who actually has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege with relation to such security.

(c) It shall be unlawful for any member of a national securities exchange directly or indirectly to endorse or guarantee the performance of any put, call, straddle, option, or privilege in relation to any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(d) The terms "put", "call", "straddle", "option", or "privilege" as used in this section shall not include any registered warrant, right, or convertible security.

(e) Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by

such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

(f) The provisions of this section shall not apply to an exempted security.